

PUBLIC-PRIVATE PARTNERSHIPS

**Successes and Failures in
Central and South Eastern Europe**

EDITED BY

**Dušan Damjanović
Tatijana Pavlović-Križanić
Gábor Péteri**



**OPEN SOCIETY
FOUNDATIONS**

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Foreword

Public-private partnerships try to achieve the best of both worlds. Hopefully, they provide local public services with both the local government's democratic accountability and the private sector's management skills and cost efficiency.

This collection of case studies examines how far these ambitious aims have been achieved in five Central and South Eastern European countries. They illustrate success in modernizing and expanding public infrastructure, by raising extra capital and recovering it over a longer time span than possible within a standard public budget. They also demonstrate the ability of private enterprise to supply technical capacity to design and manage plants serving larger catchment areas than individual municipalities and achieving more demanding environmental standards.

The inevitable risks of partnership are also illustrated. Efficiency relies heavily on the competitive tendering process—the integrity of its management by the municipal administration, the availability of multiple suppliers and the ability to specify at one moment of time the service needs with which the partner must comply. Partnership also runs the danger of fragmenting overall responsibility between the municipal and private sector partners with consequent costs in efficiency and responsiveness.

These accounts of country experience also raise a dilemma that has emerged in Western Europe. Public accountability necessitates a tight and complex legislative framework that can restrict the capacity and appetite of the private sector for such partnerships, and thereby constrain the competition on which its efficiency and transparency depend.

This volume is a valuable contribution to the public service reform literature at a time when the flow of European structural funds is facilitating major improvements in public infrastructure but economic recession is restricting other sources of capital and putting pressure on the users' pockets and municipal budgets from which running costs have to be met. LGI warmly extends its thanks to PALGO in Serbia for organizing the conference where these papers were submitted and to Gábor Péteri for editing the volume and presenting a digest of its main issues and conclusions.

Finally the reader should note that these reports were written in 2008, so they do not discuss changes in public-private partnerships and the impact of the economic downturn since late 2009.

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November 2010

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THE RISE OF PRIVATE INVOLVEMENT IN THE PUBLIC SECTOR

Business-oriented collaboration between governments and the private sector is widespread. Public services are provided by the private companies in return for income from public funds. This “partnership” in reality is a simple market transaction, which might take various forms in a wide range of public service areas. On one side, there is a national or local government—the *purchaser* of services, products, or works—on the other side is a private company—the *producer*.

Several characteristics of public-private partnerships (PPP) make the relationship more complicated. First of all, the incentives of the service provider are very different from the motivations of the client, a public entity. Secondly, when public and private parties agree to cooperate, they have to develop appropriate planning, procurement and management practices as well as organizational schemes and payment methods.

Under partnership arrangements, private actors are usually involved in the public project design from the early stages of a government decision. The actual organizational form of project implementation might be jointly controlled by the two types of potential owners, the public and the private entities. The payment could be a simple budget transfer or the contractor might be authorized by the elected government for collecting public revenues.

Classical forms of PPP tended to be initiated by central governments in the form of concessions. The Private Finance Initiative (PFI), launched in the United Kingdom in 1992, was the first comprehensive government policy designed with this logic in mind. Local PPP projects were simpler, but came to be more widespread under various organizational and financing schemes.

The need for public and private partnerships has evolved gradually since the early 1980s, when serious criticism emerged towards inefficient and unresponsive public service providers. At that time, as a reaction to the oil crisis and following a conservative shift in economic, social, and political thinking, two parallel reform trends evolved in the public sector. These reforms focused on the transformation of the government by (i) promoting decentralization and (ii) moving service management out of the public sector through privatization and other service mechanisms based in the private sector.

Both of these trends in reform aimed to improve public services by separating the roles of provider and producer, and developing new forms of accountability by putting the users (the voters) of these services in the center of public decisions through improved customer orientation. Eventually, new techniques of public management were invented on the same principles in other areas of public administration and governance.

However, we are now witnessing an overall shift in the perception of the public sector: its roles, functions, and management rules are changing. In this new era—which began with the present economic downturn—public choice theory and the overuse of private sector mechanisms have been met with growing criticism. After three decades

of experiments and innovation in the public sector, fears are growing that businesses are too deeply involved in public service provision.

The economic downturn has changed the macro-economic and fiscal conditions for national and local governments. They became more concerned with increasing budget deficits, the emergence of new social problems, and the deterioration of their revenue base. These unexpected fiscal problems called attention to the long-term consequences of possible inefficiencies in public-private partnerships. It has been widely claimed that more power has to be allocated to the state as an owner, not just as a regulator. The market is regarded as a mechanism that creates monopolies, further increasing social inequalities. Hopes are high that stronger governments will be more effective and fairer.

In this specific period the main objectives of this publication on PPPs is the sharing information in support of sounder policy development. The target audience includes decision-makers at different levels of government. But our intention was not to write another guidebook; several manuals have already been prepared by various international organizations, technical assistance and training programs. Our aim is to assist local policymakers—including NGOs—by clarifying the key features of public-private partnerships. We hope that the experiences of the five countries presented here will aid in the preparation of capital investments financing schemes and in managing these complex forms of service provision.¹

WHAT IS PPP?

Public-private partnership is based on the concept of sharing risks. There are several factors that influence the successful management of joint public and private projects. Large, technically complicated infrastructure projects, with complex funding schemes, depend largely on external factors. This is especially true when the demand for these services is influenced by political decisions on eligibility, the price paid for the service, and the level and form of social subsidies. The probability of failure due to any of these factors is only one of the risks associated with PPPs. There are other internal risks related to internal factors, like construction, technology, and management.

A project or service can be regarded as a public-private partnership scheme when the construction risks, plus either the demand or availability risks, are managed by the private sector. This definition is used by the European Union, where public contracts are separated from off-budget activities primarily for accounting purposes. In the case of PPPs—beyond the successful completion of the construction work—the private partner is responsible if there are shortfalls in the market for the service (demand risk) or if the service is not performed at the level agreed (availability risk).

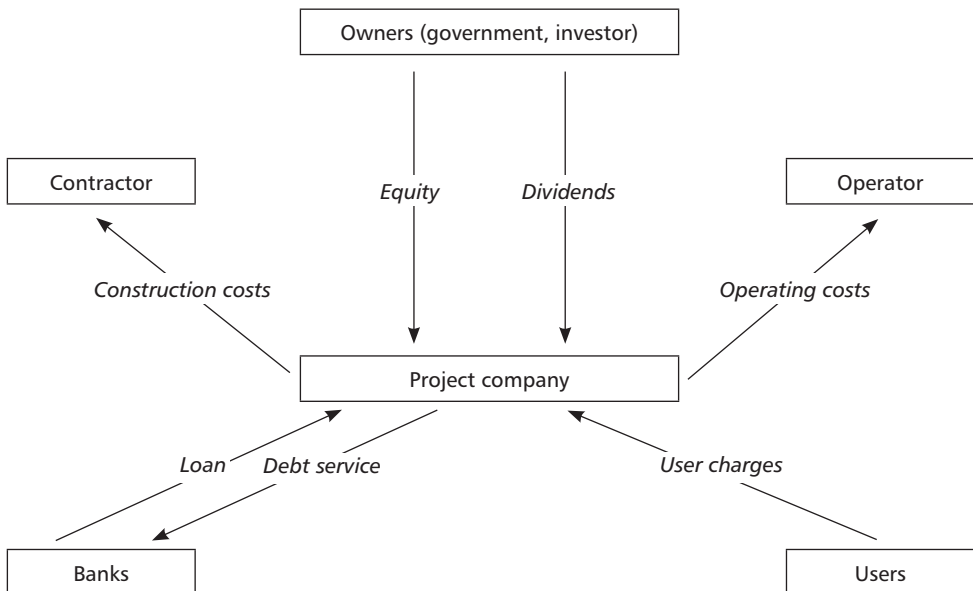
PPPs can take two forms: a simple *contractual* partnership, when the private sector is involved in the design, financing, and management of a service; or *institutional* PPPs,

when separate entities are jointly owned by the two partners (Green Paper 2004). Co-operation between public and private bodies is stronger in the latter case. The scale of private sector involvement is proportional to the level of private sector risk. The forms of PPPs vary from the simple design and build contracts through design-build-operate-transfer schemes to complex concession agreements.

In a classical PPP scheme there are typically six types of actors connected through specific flows of funds. In the case of a classical institutional PPP, the (i) *project company* is in the center of the service. Initial capital is put into this company by the (ii) *owners*. In return they expect a dividend of some kind, either cash or subsidized services. This project company might raise funds on the market, for example by borrowing from (iii) *banks*, which collect the debt service from the project company.

When building a facility the project entity contracts a (iv) *construction* company, whose costs are paid from the revenues generated. The (v) *operating* entity is developed either within the project company or as a separate contractor, which is compensated for its operating costs. The financial basis of all these flows of funds is the (vi) *service user*, who pays fees or makes other financial contributions. The owner—the local or central government—might also secure funds from general tax revenues for operational purposes. These roles might be merged, because sometimes several functions can be assigned to a single entity (e.g., when the operator is responsible for construction).

Figure 1.
Actors and Flow of Funds in PPP



Source: UNIDO (1997).

There is a *broader definition* of public-private partnership, as well. Typically in urban development, public investments (e.g., building an access road, reconstructing a slum area) contribute to economic development (creating jobs, increasing the local tax base, etc.). In return, when the actual flow of funds is tapped under more complex institutions, there are indirect benefits for the public sector. In the United States these forms are widely used as special districts or other legal forms of tax increment financing (when a specific increase in tax revenue is used to finance a project). In Europe the common objectives are formulated during the planning process and included in the urban development agreements.²

These characteristics of public-private partnership schemes already display a distinction from other organizational forms, policy preferences, and traditional methods of public service delivery. The major features of these two approaches of public service provision are compared in Table 1.

Table 1.
Comparison of Classical Public Sector Schemes and PPP

	Public sector	Public-private Partnership
Policy objectives	Responsivity (quality and effectiveness)	Best use of funds (efficiency, risk allocation)
Focus	Narrow: capital or current budget	Broad: full financing of capital and current expenditures
Funding	Public: own, shared, grant revenues and public sector borrowing	Public and private funds, loans, user charges, other publicly controlled revenues
Ownership	Public, with limited contractor influence	Usually mixed
Timing	Short term (election cycle)	Long term (recovery within the project life cycle)
Procedure	Simple: political, administrative. Legal, compliance with the rules and regulations	Complicated: must conform to public procedures and private sector rules. Transparency is a high priority
Capacity	External: plan, build, manage, supervise	Internal: negotiate, cooperate, control/audit

The major differences between classical public projects and PPPs are clearly visible along these lines. In the case of public projects, the policy preferences are determined by the needs and efficacy of services, while under PPP schemes the primary task is the efficient use of the available private and public funds. Consequently, PPPs focus on the total costs of service provision, while in the public sector, decisions on capital and current budgets are usually separate. Sources of funding are more diverse in PPPs and the private owners have a greater say.

Timing of the PPP projects expands beyond the election cycle—they are evaluated over the long term, throughout the entire life of the project. Decision-making is simpler in the public sector, while the involvement of private actors requires the observance of new rules. The capacity for managing public-private partnerships should be developed internally, because the public actor usually does not have the required negotiation, control, and cooperation skills. When projects are financed by the public sector, technical expertise is available externally.

WHY PPP?

Governments are under constant pressure to improve the performance of public services with limited resources. In some countries presented in this publication, for example Hungary or Serbia, where legal and administrative limitations rendered public organizations less responsive than private entities, governments hoped actors from the private or the nongovernmental sector would be able to deliver *more and higher quality*.

Such innovations are highly necessary during periods of fiscal restriction, when pressure on the public sector to *decrease public employment and overall expenditures* is especially high. Under some PPP schemes public employees might be shifted to the private contractor or the concessionaire, reducing the number of public employees.

Beyond decreasing labor costs, public-private partnerships aim to *attract additional resources* to the public sector. One-time investment costs can be allocated over a longer period, which better fits the revenue generation rules of the public sector. In the decades before the present economic downturn the private sector was able to borrow easily for these long-term projects, generating stable revenue flow. PPPs also help public entities to comply with limitations on public debt. This is especially important among European Union member countries, where one of the Maastricht criteria is that public debt should not exceed 60 percent of GDP.

In the utilities sector, better public services were sought through *technology transfer*. Especially during the early years of the transition, foreign companies had better access to modern equipment and management techniques. Compared to the deteriorated assets and obsolete technology used by public service organizations, these companies could make fast and visible improvements in service quality (municipal solid waste management, water services, etc.).

Expectations are high that PPPs will create *efficiency gains*. Contractual obligations mean construction projects are *completed on time* and their *costs are rarely increased* during implementation. These expectations were not always met, but the carefully audited PFI program in the United Kingdom confirms the advantages of PPP.

A problem with financial assessments of PPPs is that service performance targets are modified during the PPP contract period, so changes in efficiency are hard to track.

The methods used to calculate project costs might be biased in favor of the private sector. The lower costs of PPPs schemes have been questioned by the evidence—the profit margin on private sector construction works is usually 1–2 percent, while the rate of return calculated on PPP is much higher (CEE Bankwatch Network 2008).

The various PPP schemes are often *promoted by international financial institutions*. European banks (the European Bank for Reconstruction and Development, EBRD, and the European Investment Bank, EIB) and the World Bank actively support them through its Public-Private Infrastructure Advisory Facility (PPIAF) scheme. The “bankability” of these modern forms of financing public investment projects is more easily ensured if the large, international utility companies are involved during preparation. Some exceptions have cropped up recently, when support for establishing the institutional conditions for private sector participation precedes the actual funding by the international financial institutions.³

CONDITIONS FOR SUCCESSFUL PPPS

Public-private partnership is arranged within complex governance systems and influenced by the specific social and political environment. The scope and form of decentralization determines how actively local governments could take part in utilizing the benefits of PPPs. Because they had to follow new rules of public financing (e.g., in accounting) and public procurement, European Union membership has also brought significant changes to the countries studied here. Changes in the general public attitude towards privatization and private sector participation also determine the acceptance of PPPs.

For example, in the early 1990s local governments in Hungary were eager to establish various concessions and contract out schemes in the utility and communal sector. This was followed by a learning process, where agreements were sometimes significantly modified or privatization arrangements were reversed (sometimes by the same political leadership, such as the forced buyout of minority foreign shareholders in Pécs, Hungary). In Croatia, where PPP schemes were started after some delay, state institutions (the ministry of finance and the agency for PPPs) vigorously supported local capacity building in the areas of preparation, approval, implementation, and monitoring of both contractual and institutional public-private partnerships.

In Serbia, with its long tradition of special self-government institutions, progress in the private sector's participation in communal services has been slow. There is no PPP-related legislation, and local governments are not obliged to apply competitive tendering procedures. Direct negotiations are allowed only in exceptional cases.

These cases, together with many other examples, show that public-private partnership arrangements will be successful only in a supportive environment. The technical

conditions of the actual PPP projects are developed in a complex legal and institutional system. The following sections provide an initial inventory of those factors, which ultimately determine how much the public sector can benefit from the PPP schemes.

Legal-administrative Environment

The complex legal framework of public-private partnership countries of Central and Eastern Europe were developed during the 1990s. The *basic laws*, like acts on concessions or on local government were critical and necessary, but not sufficient for creating a supportive legal-administrative environment. They have to be accompanied by regulations on the technical aspects of private sector involvement: sectoral laws and strategies, public procurement procedures, diverse forms of service management, the status of public assets and especially local autonomy in managing municipal property.

Poor quality legislation and lack of administrative capacity may also discourage private initiatives. For example, under the Serbian Law on Concessions, the government is required to approve or disapprove of a municipal concession proposal within three months. The ministry has six months to prepare and submit a draft concession contract to the government. This means tendering can be delayed one or two years after the moment the concession initiative is conceived. This is the case even for cities like Belgrade that have highly developed technical, material, and professional resources.

In addition to these legislative foundations, the success of PPP schemes very much depends on the overall *rules of public financial management*. First of all, accounting rules define how the most critical decision on PPPs is made (or whether it is made at all): will a public or private financing method be more favorable? What is the cost comparison under different funding schemes?

Because revenues from service tariffs are usually the main source of financing for projects in the utility sector, autonomy in *setting user charges* becomes an important related issue. The client local governments or national government agencies must retain the power to determine prices for services provided through PPPs. Decision-makers should be aware of the options available in setting user charges and the administration should be familiar with the various pricing methods. Since affordability is also a critical condition of successful private service provision, governments must have an idea of how much the public can pay for services, what methods of *social assistance* are available, and how it will respond to non-payment or delays.

Some countries have drafted *specific laws on public-private partnerships*. For example, Croatia and Poland have recently passed dedicated legislation on the general rules governing PPP, while the Czech Republic and Hungary were able to develop a diverse system of public-private partnerships without specific legislation, instead simply adjusting

existing laws to the new requirements. This is common practice in the EU, because a 2005 communication from the European Commission (EC) states that specific regulations on all public contracts and concessions are unnecessary (EC 2005).

Local Incentives for Innovation

Public-private partnership is still not a common form for financing capital investments. According to a global survey, only four percent of all public sector investments are implemented within some form of PPP. Nor do they fit into the traditional forms of funding for local government capital investments. Municipal investments are mostly financed through national budget transfers and matching grant schemes. However, local governments are responsible for more than half of public sector investments, so their preferences in selecting financing mechanisms determine the means of funding.

Even classical forms of debt financing are utilized at the lower levels in transition countries. The EU average for local government outstanding debt as a percentage of GDP is almost six percent, while in the most decentralized Central European countries, like Hungary or Poland, it is only approximately two percent (Dexia 2008).

The system of intergovernmental finances primarily inspires local governments to search for alternative forms of financing for capital investment projects. In many countries of South Eastern Europe the low share of own revenues and almost absolute lack of own capital revenues forces local governments to rely on transfers as the single source of capital investment financing. Because local governments cannot assign municipal revenues to infrastructure projects, limited municipal influence on the setting of user charges also serves as an obstacle for PPPs. Centralized planning and funding schemes, as well as overregulation of capital investment during project design also hinder public-private partnerships at the local level because they create legal and administrative barriers to borrowing and innovative forms of capital investment financing.

Gradual reforms in all these areas might support the wider use of PPPs. When the allocation of capital funds becomes *less politicized* and local governments have a *greater stake in financing investments*, innovative forms of project funding will likely become more popular. It is also critical to change the management rules of local public utility and communal service organizations. In some countries top positions are assigned during political negotiations, leading to overstaffing and lowered efficiency. Public-private partnerships with a greater emphasis on the economic aspects of service provision might help change this.

EU Policies

European Union policies target public-private partnerships from various angles, because PPP is not included in the legal institutions or terminology. Since 2004, several EU documents have dealt with PPPs and developed the overall strategies and regulations on (i) how PPP should be entered in accounting documents, (ii) procurement rules and (iii) how they are supported, and (iv) why PPP schemes are useful during economic recovery.

The *statistical approach* and accounting regulations became relevant during EU enlargement in 2004. The principle of government debt accounting is based on the risk allocation method within public-private partnership. According to the European System of Accounts, projects could be regarded as nongovernment assets if they met the following dual criteria: the private partner bears the construction risk, as well as either the availability or demand risk.⁴ Otherwise it is a public asset and the loan financing the project forms part of the public debt.

Early involvement of private actors in project development has influenced *public procurement* rules as well. In such cases, when works and service contracts are above the threshold, standard rules must be followed, but a competitive dialogue with the potential contractors is allowed. PPP schemes are usually rather complex, so governments would need technical input from the private sector. All public contracts or work concessions must follow the basic principles of transparency, equal treatment, and non-discrimination.

Similar principles are followed by the EU *grants policy*. Public-private partnership projects are equally eligible for public funding, both at the national and EU level. The main sources of potential funding are Structural Funds, European Investment Bank loans, and other EU schemes like the trans-European transportation network and the Joint Technology Initiative program. There are other joint development programs with the EIB and EBRD that include infrastructure projects, urban development, and micro- and medium-size enterprises.⁵

Recent EU *economic recovery plans* have highlighted the importance of public-private partnership. In general, financing opportunities for the private sector are declining and many governments have stopped or postponed these projects. However, in some cases public support for PPP might be an option for more efficient use of the means available for economic stimulus programs. The co-funding requirements for EU funds are high, and they might also crowd out private resources, which could justify more extensive use of PPP schemes. Some countries have introduced state guarantee schemes (France, Belgium, and Portugal); new types of public sector debt facilities (United Kingdom, Germany, and France) and also simplified the management rules of procurement for PPP projects (EPEC 2009).

The Capacity to Design, Negotiate, and Manage PPPs

Public services involving private partners are more complicated than those that are internally managed. In the planning stage, when policy objectives are clearly set, the need to inform all interested parties is greater. An agreement on strategic goals and a better understanding of stakeholder motivation helps to manage potential conflicts during later stages of the project.

During project preparation and implementation, specific issues of employment security, management of social problems, and flexibility in service standards might come up. Regulatory capacity for PPP projects has to be developed, especially at the local government level, where customer representation and direct political influence might require completely new management skills.

Experiences with PPP projects show that beyond technical knowledge, a better understanding of commercial logic and the broader institutional environment are most important. An overall business capability dominates the list of skills and capacities in the public sector: understanding end-users' needs, procurement options, the strategic context and supply side incentives, communication and negotiation skills, ability to manage advisors, retain competitive tension, etc. According to a recent National Audit Office report these skills outnumber strictly technical expertise of project preparation and management (NAO 2009).

All this capacity might help *balance information asymmetry*, which otherwise puts the contractor-operator into a favorable position in comparison with the client-regulator local government. Governments usually rely on information provided by contractors, because the level of technical expertise is lower within public administration. This situation might have negative consequences. In response, bureaucratic pressure on the operator increases, or political influence on the contractor is enhanced (for example, pressure for cross subsidization or introducing windfall tax on anticipated profits).

One of the most common criticisms of PPP projects is that the interests of the business sector lead to unnecessary *increases in project size*. A World Bank study showed that about half of total infrastructure PPP contracts were awarded to 10 percent of the largest companies in developing countries. The water sector is especially dominated by companies like Veolia Environment or SUEZ (Estache 2009). The study concludes that despite the fact that larger projects result in economies of scale, a bundling strategy would limit competition, because only a few companies will qualify.

During project implementation, complex projects might limit clients' powers. Agreements *increase rigidity* in service delivery, despite changes in demand or technology. Ultimate managerial responsibility is hindered by PPP and subcontracting, simply because governments are not always in a position to guide and instruct contractors.

These management problems might be partially solved by greater *transparency*. The most critical step in public decision making over capital investments is project design.

The investigation of corruption cases showed that contractors and investors are able to increase costs and promote use of expensive technologies. Governments, then, should be able to control these early periods of capital investment planning and project design. During this stage of PPP preparation, project selection should be harmonized with local development plans and sectoral development strategies.

Partners and contractors are usually selected through a competitive tendering process. This process may differ from classic public procurement, because the PPP tender process is implemented in stages, with the active involvement of potential bidders. A government plan's first confrontation with reality often occurs during negotiations with prequalified bidders. Project appraisal and design require that an iterative process between client and contractor proceed throughout the negotiations on outline proposals, preliminary, and final invitations.⁶

Transparency could be increased by registering all PPP contracts, as is compulsory in Croatia and the Czech Republic. Openness during the public decision-making process over PPP agreements can be improved by signing an "Integrity Pact" (Transparency International 2010). This is a written agreement that covers rejecting bribes, collusion among competitors, and disclosure of information on payments related to the contract. Violation of these practices might lead to loss of contract, blacklisting, fines, and criminal actions. It is more a preventive tool than a real weapon against corruption. However, integrity pacts might have serious consequences on the market position of a company (and civil servants as well).

Another way to support informed decisions on complex projects is improve the *knowledge base* on PPP. The EC has launched an organizational capacity building program at the European Investment Bank. The "European PPP Expertise Center" (EPEC) improves expertise in both EU member and candidate countries through analysis and dissemination of practical guidance.⁷ The "C.R.E.A.M Europe PPP Alliance" is a professional and capacity building network for promoting these forms of capital investments. There are also national coordinators and innovation focal points of PPP in countries like the Czech Republic (PPP Centrum) or the ministerial unit in Hungary.

These forms of knowledge dissemination on PPP should be supported in the countries studied here. As capacity building is needed most at the municipal level, local government associations in Southeast Europe or their regional network (Network of Associations of Local Authorities of South-East Europe, NALAS) might become centers of information exchange.

Managing Risks

Governments have the ultimate responsibility for providing a service included in their mandate. In this sense there is no limit to public risk, because utilities like water or

heating must be delivered and public sector employment should be protected as well. However, the risk, defined as the “factor, event or influence that threatens the successful completion of a project in terms of time, cost or quality” might be limited (EU 2003). Risk management means assigning responsibilities to PPP parties able to successfully deal with the problem. As the case studies show, the most important threat to PPPs is imperfect risk analysis.⁸

The risks related to PPP projects can be categorized in many ways. The statistical approach specifies construction, availability, and demand risk. Another grouping might be by the separation of legal and commercial risks when the former is clearly managed by the government, while the latter is managed mostly by the private partner. It is important to further specify subcategories of risks—it is helpful to assess them, then decide which party might be able to limit which type of risk, and who is responsible for any failures. The categories used by the European Union guidelines include risks associated with foreign exchange, increased political and public acceptance, and the environmental and archeological risks associated with large infrastructure projects. Overly rigid contracts might affect profitability of PPP projects, where the ways potential gains will be shared with the public sector are not specified.

In designing public-private partnership deals, complex assessment methodologies have been developed. Value-for-money analysis is used widely in the United Kingdom. To determine strictly financial factors, the method is known as the *public sector comparator*. This means comparing the costs of a PPP with the costs if the project were carried out through public procurement (OECD 2008). It also assumes public debt financing, not only service payments from the operational budget that support private financing in the PPP.

Quantifying all potential costs of a hypothetical public project, starting from design to operation, is quite complex. Changes in assets also have to be forecast. Here, as in any feasibility study and impact assessment report, critical factors include the rate of inflation, the discount rate, and the calculation of overhead costs.

ECONOMIC DOWNTURN: OBSTACLE OR OPPORTUNITY

Local government capital investments form a significant portion within the public sector: European Union member countries spend more than half of their capital at the local level (Péteri 2009). This amount is 1.5 percent of GDP, so any change in the volume of capital expenditures has an impact on the economy. The economic downturn that started in late 2008 has already had an unfavorable effect in some countries. Assessments of its effect on local governments that same year already showed a four percent drop in the share of local investments within general government public investment. In some countries, this decline was exacerbated during the first quarter of 2009

(e.g., –22 percent in Hungary), while in other countries it did not show its effects (an 11-percent increase in Croatia and Poland).

The overall declines in public funds will have a negative impact on the public-private partnerships in the countries studied here. As the EPEC research report showed, the first nine months of 2009 saw an overall drop of 30 percent in the volume and number of PPP-funded schemes.

The closure or slowdown of PPP projects was primarily caused by two factors. First, funds made available by the banking sector dried up or became more expensive. The financial crisis halted more relaxed lending procedures in both private and public sectors. In some countries, preferences regarding funding for large local government projects changed. They started to experiment with bond issues, mainly to supplement incoming EU funds for public sector projects (e.g., Hungary and Poland). Second, use of market-based solutions in the public sector met increasing reluctance. The economic crisis had to be managed by major government bailouts and public takeover of formerly private contracts—sometimes joint utility companies were bought outright. In this period of public hostility to market-based service management it is rather risky for local leaders to launch major PPP programs.

However, the benefits of alternative service delivery arrangements cannot be completely neglected. New forms of public management have made significant improvements in service provision and government operation. There is still room for private sector based initiative, technology and management, market incentives, and private capital, which would create new opportunities for partnerships with the public sector. Evaluation of the accomplishments and failures of these partnerships can guide public policy and private actions at decisive stages in the future.

European Union policy also emphasizes the importance of PPPs in sectors like the environment, energy, transportation, and even health care. After the present temporary decline, the number of public-private partnerships is likely to increase. Obviously lessons have to be learned from this recent experience. The relationship between the two actors should be made more balanced, and the accountability of the PPP decision-makers should be increased through greater transparency.

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NOTES

- ¹ For their useful comments on this introductory chapter, I would like to extend my gratitude to my co-editors Dušan Damjanović and Tatijana Pavlović-Križanić, my colleagues working on the country chapters, and Ken Davey at LGI.
- ² For example, in Hungary Law LXXVIII of 1997 on the Built Environment introduced the “settlement development contract.” This contract sets the rules for sharing responsibilities between the private sector (mostly investments) and local governments (typically guaranteeing favorable urban planning and zoning regulations).
- ³ For example, the World Bank PPIAF technical assistance projects on public utility company reform strategy in Serbia, Republic of Macedonia; or the assessment of governance structures, managerial capacity, financial, and operational performance of Podgorica Waterworks before the actual privatization.
- ⁴ Eurostat News Release 18/2004: Treatment of public-private partnerships.
- ⁵ Joint Assistance to Support Projects in European Regions; Joint European Support for Sustainable Investment in City Areas; Joint European Resources for Micro to Medium Enterprises.
- ⁶ See CREAM (2010), EU (2003) and UN (2007).
- ⁷ Available online: <http://www.eib.org/epec/about/index.htm>.
- ⁸ From a statement by Ken Davey at the LGI Workshop in Belgrade on October 24, 2008.

The Marketization of Public Services at the Municipal Level

Public-private Partnerships in Bulgaria

Stefan Vladkov and Angel Markov

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EXECUTIVE SUMMARY

Although public-private partnerships (PPPs) are a relatively new practice for Bulgarian municipalities, a number of surveys show that Bulgarian local governments have begun to give increasing importance to partnerships with the private sector, and often consider the approach of implementing infrastructure projects through PPPs due to their ability to overcome constraints like a lack of municipal finances and infrastructure.

The concept behind the term public-private partnership is not always well understood in Bulgaria where there is a tendency to classify all types of business relationships between a municipality and the private sector as public-private partnerships. Bulgarian municipalities have relied on PPPs mainly as opportunities to obtain new infrastructure, while not always appreciating all their features. Keeping this in mind, it is not surprising that some undertakings have resulted in major misunderstandings or agreements where the public interest has been the last thing to be considered in managing PPP contracts. The essence of a PPP lies in the positive impact on the community as a result of improved services and infrastructure, not on the particular form of business relations between the municipality and the private sector under a PPP agreement. Local governments need to shift their focus from the acquisition of assets towards the provision of high quality services.

As yet, Bulgaria has no special legislation regarding PPPs, and any future legal framework needs to provide sufficient flexibility with respect to the content and nature of the enterprise. PPPs are defined and governed by a complex interaction between national and municipal legislation and regulations, as well as by the PPP contracts themselves. This *ad-hoc* approach to PPPs on the part of the government has led to uneven results from a public interest point of view.

In the absence of a distinct national law governing PPPs, Bulgarian ministries have resorted to issuing their own internal guidelines, while the general framework in which municipalities may design and implement PPPs, depending on their final form and purpose, is taken from a combination of the Local Self-government and Local Administration Act, the Concessions Act, the Public Procurement Act, the Municipal Property Act, and the Social Assistance Act. Some checks are exercised on these endeavors to form PPPs by the National Audit Office as well as a national registry and guidance is available from the national level, where permission to form PPPs ultimately lies. Those municipalities that have been ill-advised or clearly violated the procedures that would normally result in a mutually beneficial partnership have gone on to suffer from severe financial repercussions, inadvertently found their property portfolio much reduced due to transferring their properties to joint stock companies in which they have little leverage to stop any further sales, or simply not maximized the potential returns of the PPP that they entered.

A review of Bulgarian practices demonstrates that the success of a PPP largely hinges on the overall planning process and the management of the most essential factors, such

as PPP organization, risks, partners, contractual arrangements, possible impacts, overall management, municipal policy, and its very objectives. One of the main problems has been insufficient risk evaluation and allocation, leading to a heavy financial burden for some local governments. For example, one of the key components of every PPP is the distribution of risks, and calculating such risks is a new and uncommon task for municipalities often overwhelmed by the new responsibilities brought by political and administrative decentralization and democratization and unable to deliver on the promises of better, more efficient services.

That is not to say that cities, towns, and municipalities in Bulgaria have not tried in either a concession or a publicly-owned company to better their services or infrastructure for the greater public good, whether upgrading and managing a municipal swimming pool in Blagoevgrad, developing urban areas in Burgas, rebuilding a youth center in Gabrovo, calling for a large tender to refurbish Sofia's water supply and sewage network, or developing a complex local economic development project in Sevlievo, as the cases in this latter part of this study will make apparent.

This study goes on to recommend that the Bulgarian government act to resolve and regulate the glaring and possibly illegal practice of property transfers to non-transparent joint stock companies; amend the Concessions Act to make it more flexible to local conditions, hand in hand with encouraging municipalities to develop local strategies for property management as well as local policies on public-private partnerships, whether for infrastructure financing or service provision; and insist that all PPPs have a clear assignment of responsibilities. Without these few regulatory steps, PPPs in Bulgaria will continue to yield sporadic results for municipalities, the private sector, and citizens alike.

1. PUBLIC-PRIVATE PARTNERSHIPS—AN OVERVIEW

1.1 Definition of PPP

There is no single agreed upon definition of the term Public-private Partnership (PPP). But various definitions do exist in the practice regarding the substance of the public-private partnerships. Since the concept of PPP is based on the idea of constantly improving and finding more efficient ways to provide public infrastructure and services, the legal framework needs to provide sufficient flexibility with respect to the content and nature of the various undertakings.

In a broader sense, PPP is defined as the implementation of *all known types of co-operation* between the public sector and private partners, which, in many cases, leads to the establishment of joint ventures. The guidelines of the European Commission for successful PPP define the PPP as a “partnership between the public sector and the private sector for the purpose of delivering a project or a service, traditionally provided by the public sector.” Through this partnership, the strong sides of each of the two sectors (public and private) are supplementing each other in the provision of services or in the building of an object for the benefit of a particular community. As each sector does what it is best at, services and infrastructure are provided for society in the most economically efficient manner. Such partnerships are characterized by the sharing of investment, risk, responsibility, and reward between the partners.

Bulgarian legislation does not explicitly provide a common legal definition of the public-private partnership. Some documents have been issued by various ministries that provide a definition of PPP and its forms for the purposes of a specific sector or types of projects. The Ministry of Finance has published its “Methodological Guidelines for Public-Private Partnership,” where the following definition is provided: “The PPP is a long-term contractual agreement between persons from the public sector and the private sector for financing, building, reconstruction, managing or maintaining infrastructure, where the private partner takes the construction risk (project completion) and at least one of the two risks—the risk of availability of a provided service or the risk of service demand.” This definition takes into account the Eurostat guidelines on the conditions under which a PPP could be taken off the national balance sheet.

The Ministry of Economy and Energy has adopted internal rules for carrying out public-private partnerships where it defines the forms of PPP as: (1) a contract for design, construction, maintenance, operation and management of an object that is a public state property; (2) a contract for design, construction, maintenance and management of an object that is a private state property; (3) a contract for provision of services; (4) commercial company; (5) civic partnership.

1.2 Forms of PPPs

While the roles and responsibilities of the public and the private sector partners differ in individual partnership initiatives, the public-private partnership agreements may be achieved under various forms, depending on the sector, the risk allocation, the financing and operating arrangements, and the potential implications on taxpayers. The subject matters of establishing such partnerships vary but PPP generally involves the financing, design, building, operation, and maintenance of public infrastructure and services.

The common forms of public private partnerships based on international experiences are:

- **Operation and Maintenance.** In this model, the public authority contracts with a private partner to operate and maintain a publicly owned facility.
- **Design–Build–Operate–Transfer (DBOT).** In this model of PPP the private party is responsible for the design, building, and operation of infrastructure, which is used by the public sector. The ownership of the assets has to be transferred to the public sector at the end of the contract. Regular payments to the private sector are made for the provision of services in compliance with initial specifications.
- **Build–Operate–Transfer (BOT).** This model of PPP is similar to the DBOT described above, with the only distinction that the public sector provides a drawn up design of the necessary infrastructure for the provision of services by the private partner.
- **Build–Transfer–Operate (BTO).** This option for PPP is close to BOT, but in the present case the public sector becomes the owner of the infrastructure from the very beginning of the contract.
- **Build–Own–Operate (BOO).** Here, the private party provides for the construction, financing and operation of the infrastructure. A BOO differs from a BTO in that the private party does not have the obligation to transfer the ownership of the assets to the public sector. There is an opportunity for the public sector to acquire the assets, by purchasing them at their residual balance value, after the end of the contractual period.
- **Concession.** In the large sense of the definition given by the interpretative communication of the EU Commission, under a concession “the public authority entrusts to a third party ... the total or partial management of services for which that authority would normally be responsible and for which the third party assumes the risk.” The ownership of assets remains usually within the public sector, while the private party is entitled to cover its expenditures through imposition of user fees.

Public procurement refers to the purchase, lease, rent, or hire of a good or a service by a public authority. Procurement is chosen because of the simplicity of desired goods or services, the possibility to choose from numerous providers, and the aim to minimize costs. Even in procurements involving construction work, typically the relationship is short term and the financing is provided by the public sector. PPPs are related to traditional public procurements in that private partners are often selected on the basis of public procurement procedures.

PPPs are more complex, frequently larger in financing requirements, and are long-term relationships as opposed to the one-off relationships under public procurement. Projects implemented through a PPP are largely financed by the private sector. The transfer of the risks to the private partner also represents a major difference between the PPP and the public procurement. PPPs frequently provide the private partner with the right to operate over an extended term, to charge fees to users, and to assume key responsibilities, e.g., design, construction, finance, technical and commercial operation, and maintenance.

2. THE LEGAL FRAMEWORK OF PUBLIC-PRIVATE PARTNERSHIPS

Bulgarian legislation does not explicitly reconcile the PPP relationship. There is no special law on public-private partnership. PPPs are defined and governed by a complex interaction between national and municipal legislation and regulations, as well as by the project contractual agreements. New legislation was adopted in 2009 and existing acts have been amended in order to incorporate EU legal requirements into public contracts and concessions (Directive 2004/18/EC). Some of these amendments involve the regulation of issues related to transparency, publicity, free competition, and the guarantee of public interests in the procedures. The recently amended Local Self-government and Local Administration Act (LSGLAA), together with the Concessions Act and the Public Procurement Act, provide the general legal framework for public-private partnerships in Bulgaria.

2.1 Local Self-government and Local Administration Act

The general legal framework for carrying out public private partnerships is found in the Local Self-government and Local Administration Act. It provides the legal basis for cooperation and partnership of municipalities with legal or natural persons for achieving objectives of mutual interest and for assigning municipal activities to external partners. The public-private partnership takes place on the basis of a signed cooperation agreement,

that has to be approved by the municipal council. In the cooperation agreement, the following items should be specified:

- i) the parties under the agreement;
- ii) the scope and subject-matter of the agreement;
- iii) the purpose of cooperation;
- iv) the forms of cooperation and/or the type of legal person: for example, cooperation for implementation of a particular project, activity or establishment of a legal body with profit or nonprofit purpose between municipalities, or between a municipality and legal and/or natural persons;
- v) the rights and obligations of the parties;
- vi) the share of participation by each one of the parties with financial resources, property, and/or other forms of participation, for the achievement of the common goal.

The LSGLAA also gives unrestricted rights to municipalities to perform business activities, to create partnerships with business organizations, and to invest financial resources and properties in business activities.

2.2 Municipal Property Act

The rules and procedures for the commercial activities of municipalities are specified in the Municipal Property Act. The municipality may participate in different forms of economic activities with financial resources except subsidies from the state budget. Also, a municipality may participate in commercial entities provided its liability does not exceed the amount of its shares. Municipalities may not participate in unlimited liability commercial entities. The municipality may make a decision for a partnership arrangement with legal or natural persons through the establishment of a joint stock company.

The registration of such a company is subject to the provisions of the Commercial Act. Municipal councils are obligated to adopt an ordinance regulating the establishment of joint companies and the exercise of ownership rights of the municipality in these companies, according to the requirements of the Municipal Property Act.

In reality, through these types of joint ventures, the municipality becomes a commercial entity, which participates equally in the market with the rest of the commercial entities that have been registered and operate in accordance with the Commercial Act. The practical implementation of this type of institutionalized public-private partnership shows that the municipal contribution to almost every joint venture company is limited to the appropriation of real estate property, without taking into account the interests of

the local community. Details of the practice of joint stock companies with municipal participation are given in the next section of this paper.

2.3 Concessions Act

The Concessions Act is the general act that regulates public-private partnerships between the municipalities and the private sector. As a legal instrument, the concession has been a stimulus for public-private partnerships in Bulgaria for a long time. After a period of suspension, the concession has been reinstalled through the adoption of the Constitution in 1991. Later, concessions were regulated in a Concessions Act (1995). In view of the accession of Bulgaria to the EU and the harmonization of the Bulgarian legislation with the EU requirements in this field, a new Concessions Act was adopted in 2006 and further amended in 2007 and 2008. The Concessions Act determines the rules and procedures for granting a concession. It outlines, in detail, the whole process, including preparation, tender procedure, content of the contract, and overall control of the implementation of the concession contract. Further regulation is provided in the rules for the implementation of the Concessions Act, adopted by the Council of Ministers. A large part of the Concessions Act concerns procedural matters.

According to the Concessions Act, a concession is defined as the right to operate a facility for the public interest, made available by a grantor to a merchant (the concessionaire), in exchange for the latter's obligation to build and/or operate and maintain the facility subject to the concession at his/her own risk.

Types of Concessions

Depending on the object of the concession, three types of concessions are defined—public works, services, and mining concessions.

- a) *The public works concession* represents the right of the concessionaire to build a facility and operate and manage the constructed facility for a defined period.
- b) *The service concession* represents the right of the concessionaire to manage and operate a public facility. It may also involve partial extension, partial reconstruction, partial rehabilitation, or renovation of the object of the concession.
- c) *The mining concession* represents the right to extract ores and minerals, financed with concessionaire funds and done at their own risk.

As seen from the above definitions, the Bulgarian legislation regulates, by force of the same act, the conditions and the procedures for awarding both public works and service concessions. The procedures for both types of concessions are identical. As for the mining concession, a detailed regulation of the procedure is provided in the Ores and Minerals Act.

Terms of the Concession

The concession is provided on the basis of a long-term contract with particular material interest, concluded between the grantor and the concessionaire, for a term not to exceed 35 years, without the right for extension. Several other limits to the concession term are found in specific sector legislation.

Regarding the terms of the concessions, the Bulgarian Concessions Act does not differentiate between a public works concession where the amount of investments requires a longer period of partnership, and concessions for the provision of public services, including for operation and management of public assets. In the latter, large investments are not involved (i.e., in the case of concessions for dams and beaches) and it is logical to determine a shorter concession term. The specific period is subject to concession contractual agreements and is determined after taking into consideration the financial and economic indicators of the concession and the technical and technological specifications of the object.

Financing and Payments

Against the granted right for operation, the concessionaire may be obligated to make concession payments. In the cases of concessions for construction or for services, the grantor may be obligated to provide a compensation payment to the concessionaire, in addition to the right of the concessionaire to operate the object of the concession. In this case, the compensation from the grantor covers part of the expenditures for the object of concession without exempting the concessionaire from the obligation to cover the major part of the risk for construction and/or for operation and maintenance of the object of concession. The possibilities for providing compensation and making concession payments are determined in the decision to launch a concession procedure, depending on the economic efficiency of the operation of the object of the concession, as defined by the concession period and the estimated costs for construction, management and maintenance, and the projected operational revenues.

Ownership

The object of a concession may be a public or a private municipal property¹ through which the economic activity is carried out. Under a concession the grantor retains its ownership rights over the object of the concession and the improvements on it, including improvements that are not made in fulfillment of the concession contract. The improvements become property of the grantor from the moment of their arising. In case of a transfer of ownership of the concession object, the concession contractual terms remain in effect toward the new owner.

Distribution of Risks

The Concessions Act has a few provisions regarding the distribution of the risk. It stipulates that the concessionaire assume the risk of construction and operation of the concession object.

Stages and Procedure for Granting a Concession

The Concessions Act regulates in detail the whole concession process. The granting of concessions goes through the following three stages: (1) preparatory works, (2) carrying out a procedure for granting a concession, and (3) conclusion of a concession contract. The procedure for granting a concession consists of the decision for launching a procedure, the conduct of procedure, and the nomination of a concessionaire.

The mayor of the municipality plays a central role in the preparatory works and the submission of proposals for the provision of concessions for objects, which are municipal property. For objects owned by municipal companies, the preparatory works have to be performed by the person who manages the company.

The preparatory works include a justification of the concession that should be based, at least, on a legal, financial and economic, technical, and environmental analysis. The justification states the rationale for granting a concession, and specifies the characteristics of the object of concession and its basic content. Based on the justification, drafts of the following documents are drawn up:

- a) decision for opening of procedure for provision of concession;
- b) notice for carrying out of procedure for provision of concession;
- c) concession contract;
- d) documentation for participation in the procedure (in the case of an open and restricted procedure) or a descriptive document (in the case of competitive dialogue).

The types of procedures for selection of a concessionaire are: open procedure, restricted procedure, competitive dialogue, or electronic auction (as a means of additional procedure in the case of an open or a restricted procedure). In the case of an open procedure, every person is entitled to submit an offer, and in the case of a restricted procedure, only candidates who have received an invitation, after preliminary selection, may submit an offer. In the case of a competitive dialogue procedure, a candidate who has received an invitation may submit the offer only after interviews with candidates admitted to that procedure have been conducted.

Overall Control of Granting Municipal Concessions

The National Audit Office controls and oversees the overall workings of the Concessions Act, including follow-up control. The regional governor exercises control over the legitimacy of the decisions of the municipal council for the launch of concession procedures, as well as over the decision to amend or supplement them. The municipal council sends drafts of decisions for the launch of concession procedures or drafts of decisions for amending and/or supplementing them to the regional governor, and to

the ministers of Defense, interior and environment and water. These ministries assess whether the concessions might impose threats to national security and to the defense of the state; to the environment or human health; to protected territories, zones, and sites; and to public order.

2.3.1 National Concession Register

The Concessions Act regulates the establishment and the maintenance of a National Concessions Register (NCR). The body responsible for the maintenance of the register is the Council of Ministers.

The National Concessions Register is public and is accessible via the Internet.² It contains the files of all concessions and a public archive where original copies of concessions are kept. Upon conclusion of a concession contract, every grantor is obligated to submit to the NCR an original copy of the contract and the related documents. Information from the concession contract, that is determined not confidential in the Concessions Act, can be accessed from the archives under the provisions of the Access to Public Information Act.

The NCR consists of three parts—for state concessions, for municipal concessions, and for public concessions. (These latter ones are, for example, mostly financed by public funds, like the National Bank, the State Insurance Fund, or the State Health Insurance Fund.) Each part contains three sections: (a) information about procedures for granting concessions, (b) data for granted concessions, and (c) information on the execution of granted concessions, including concession payments. The scope of data that the grantors of concessions are obligated to report within 14 days after the conclusion or termination of the procedure for provision of a concession is in the Appendix to this chapter.

Although the public register contains a section on annual statistical information about state and municipal concessions, this section is not well developed and there are no data available in this field.

2.4 Sector-specific Regulations

Depending on the object of the concession, a number of sector specific acts—such as the Waters Act, the Ores and Minerals Act, the Forests Act, the Law on Black Sea Coast, the Railway Transport Act, the Roads Act, etc.—regulate the specific objects of a concession and stipulate the rules and procedures according to the specifics of the concession object. Usually, they also stipulate some obligations, limitations, and restrictions on the procedure, depending on the object of the concession, for example:

Obligation for granting concessions

The Ores and Minerals Act stipulates that the extraction of ore and minerals is obligatory and subject to a concession. The ores are exclusive state property, except for the construction materials that are municipal property. Therefore, if a municipality decides to establish a PPP for extraction of construction materials (stone, gravel, sand, marble), it is obligated to do it by granting a concession, after coordination with the minister of environment and waters.

Limits of the term of the concession

The Act on the Black Sea Coast stipulates that the concessions on beaches shall be up to 10 years. The Black Sea Coast is exclusive state property and the state may assign the management of the beaches, which are not granted to concessions, to the municipalities. For their part, the municipalities may grant a concession for beaches, whose term shall not exceed 10 years.

Obligation for coordination with a central government body

Sector specific acts contain provisions that obligate the municipalities to consult and coordinate with a central government body prior to starting a procedure for granting a concession, depending on the object. For example, the Waters Act requires such consultation in case of granting a concession for mineral waters (with the Ministry of Environment and Waters).

Regulation of concession payments

The ordinance on the principles and methods of determination of the concession payments for extraction of ores and minerals provides a detailed methodology for determination of such payments, including for construction materials.

2.5 Social Assistance Act

The provision of social services is regulated in a special chapter of the Social Assistance Act and the Rules for the Application of the Act. The same act also regulates the PPP agreements between the municipalities and nongovernmental organizations, private companies, or physical persons that provide social services. The act stipulates that the supply of social services by private bodies be based on a registration of the respective service provider in a special register to the Social Assistance Agency of the Ministry of Labor and Social Policy. In addition, providers of social services for children under 18 are required to obtain a license.

The Agency implements the state policy in the field of social assistance and social services, performs the overall control of the adopted criteria and standards for social services, issues permits for the opening and closing of specialized social services institutions and registers the providers of social services. The registration is based on submission of a set of required documents. The deconcentrated structures of the Agency control the observation of social services criteria and standards (regarding personnel, nutrition, healthcare, educational services, provision of information, organization of personal free time, and contacts).

Social services may be provided through joint participation of the public and the private sector on the basis of a contract between the municipality and the private partner. For this purpose, the mayor of the municipality may assign the management of specialized institutions or social services, provided within the community, to persons from the private sector, after holding a competition. Only suppliers of social services, who have been registered in the register to the Agency for Social Assistance, are entitled to take part in such competitions. The private sector is also entitled to apply for reception of financial resources from municipal budgets for carrying out social services, upon the observation of the approved criteria and standards.

For exercising public control over the performance of social assistance activities, every municipality should establish a public council, by decision of the municipal council. The public council is a consulting body and consists of at least three and not more than nine persons, representatives of public institutions, legal persons, and individuals, dealing with social assistance activities. It has the following functions:

- a) contributes to the implementation of social assistance policy in the municipality;
- b) discusses regional strategies, programs, and projects related to social assistance;
- c) cooperates with natural persons registered under the Commercial Act and with legal persons for the coordination of activities for the provision of social services;
- d) performs an overall control of the quality of social services in compliance with approved criteria and standards;
- e) provides opinions regarding the opening and closing of specialized social services institutions within the territory of the municipality.

The public council has the right to require information from the regional structures of the Social Assistance Agency. In case of shortcomings or feedback from service users, the public council officially informs the municipal council and the Social Assistance Agency.

2.6 Institutional Arrangements

The following central government structures have some functions with regard to the public-private partnership:

- **Public-Private Partnership Unit within the Management of EU Funds Directorate** develops strategies for the application of PPPs in Bulgaria, monitors the implementation of co-financed and investment projects, and provides methodological guidelines for the implementation of PPP;
- **The Economic and Social Policy Directorate to the Council of Ministers** provides methodological guidelines and legal assistance. It maintains the web-based Public Concessions Register.
- **The Administrative Regulation and Services Directorate within the Ministry of State Administration** performs analyses of the public administrative services and provides recommendations for their provision through PPP;
- **The Pre-accession Programs and Projects Directorate within the Ministry of Economy and Energy** is the managing authority of Operational Program “Competitiveness” where special measures concern the implementation of PPP projects;
- **Specialized units** with functions for preparing the procedures for granting state concessions and for performing the control of their implementation are established in other ministries.
- **The National Audit Office and the Agency for State Internal Financial Control to the Minister of Finance** exert financial control, including over PPP projects and contracts.

The Ministry of Finance has developed several methodological guidelines to assist the municipalities and the public institutions in the process of preparation and implementation of projects. For example, the “Methodological Guidelines on Public Private Partnership” provide guidelines for analyses needed in the process of defining and implementing a PPP project. It covers the following issues: analyses of the applicability and financial feasibility of a PPP project, financial and economic analyses, analysis of public expenditures, analysis and allocation of the risks, etc.

Currently, the government undertakes measures to improve the capacity of central, regional, and local governments in the area of public private partnership, concessions and public procurement. Within the Operational Program “Administrative Capacity” several central government bodies have received funding for projects with the purpose of increasing the capacity and strengthening the monitoring and control in the discussed field.

3. PARTICIPATION OF BULGARIAN MUNICIPALITIES IN PPP

PPP is a relatively new practice for Bulgarian municipalities and is still at an early stage of development. Despite this fact, a number of surveys show that Bulgarian local governments give high importance to partnerships with the private sector and consider the approach of implementing infrastructure projects through a PPP as an attractive alternative to the traditional model of procurement of works and services, because it can overcome constraints due to the lack of finances and infrastructure (both quality and quantity) in municipalities.

At the same time, the concept behind the term public-private partnership is not always well understood. Firstly, municipalities rely on a PPP mainly as an opportunity to obtain new infrastructure. Secondly, there is a tendency for all types of business relations between a municipality and the private sector to be classified as PPPs. A typical example is the classification of all types of joint stock companies with municipal participation as public private partnerships, although in many cases the public interest is the last thing considered in managing these companies. Therefore, it is not surprising that the public opinion about these commercial activities of municipalities is strongly negative. A public private partnership suggests that a socially significant public service or a service used by a large part of the population is provided by a private company on behalf of the public authority.

The essence of a PPP lies in the positive impact on the community as a result of improved services and infrastructure rather than the particular form of business relations between the municipality and the private sector under a PPP. In this sense, a shift in the attitude of the local governments towards PPP is needed—from focusing mainly on acquisition of infrastructure (assets) towards provision of quality services.

3.1 Problems with Municipal PPPs

The last several years have brought both positive and negative examples of PPP arrangements. The review of the practices demonstrates that the success of a PPP is largely dependent on the overall process of estimation and management of a number of factors, such as PPP type, risks, partner, contractual arrangements, impacts, overall management, and municipal policy and objectives, etc.

One of the main problems seems to be the risk evaluation and allocation, leading to an *increased financial burden* for the local governments. As one of the key components of each PPP is the distribution of the risks, their calculation is a new exercise for the municipalities because such calculations have not been a practice. Local governments find themselves in a weak position during renegotiation and are forced eventually into accepting to carry the major share of the risk, with visible effects on the public accounts in the long run.

Quite often, municipalities enter into a public-private partnership by establishing joint stock companies or by granting a concession. The concessions are mainly for operation and maintenance of public assets. Municipal PPPs with investment purposes are rather exceptional. This is logical, as in most cases these concessions involve limited financial resources and can be applied to a broad range of municipal services.

As mentioned earlier, the municipalities have an unrestricted right to perform financial and economic activities. Establishing a *joint stock company* is one of the main types of partnerships between municipalities and business entities and broadly practiced by local governments in Bulgaria. The municipal stock in such companies is almost always in the form of appropriation of municipal property. This scheme is notorious for its complete lack of transparency. The question is how the public interest is protected in this type of PPP. The regular reports of the National Audit Office regarding the management of municipal property and the management and control of the municipal share in joint stock companies show numerous examples of deficiencies that may be summarized as follows:

- a) municipalities massively allocate property into joint stock companies (JSCs);
- b) the appropriation of municipal private properties to the capital of the JSC is done without any provision of public information by the municipality regarding its investment intentions;
- c) participation of the municipality in the creation of JSCs is done without adherence to any prior developed criteria and procedures for the selection of the partner/s;
- d) selection of the partner/s is done without a competition between interested stakeholders, thus bypassing a tool that would otherwise guarantee the achievement of municipal investment goals to a largest extent;
- e) municipalities do not draw the dividend;
- f) municipalities do not have established mechanisms or procedures for monitoring, evaluating, and influencing the effectiveness and efficiency of service provision and the financial situation of the company.

A common practice exists among municipal councils to increase or decrease the capital of JSCs through appropriation of properties to the capital of these companies. In reality, most of these properties do not serve the declared activity of the company. Following the appropriation, these *properties are sold* on the market and thus the company is financed indirectly by the municipality. The end result is that the municipality is deprived of revenues that would be generated from the sale or rent of the property.

The municipal councils' decisions to appropriate properties to JSCs are not supported by detailed surveys of the current status of these properties. In addition, no specific

motivation or proof of the benefits to the municipality are given. None of these decisions are supported by financial and economic analysis. Usually the municipal councils' decisions simply stipulate which properties will be contributed to the capital of which companies and which properties will be sold.

These companies, with small exceptions, *do not carry out the main purpose* for which they were established in the first place. The research team did not find a single JSC that has been created for the benefit of the local community or to meet certain public needs. The legislation is used to transfer municipal property to private bodies free of charge or at a low price. Usually, the practice is that the municipality registers a joint stock company with a private partner (selected in a non-transparent way, sometimes without any competition) and contributes to the capital by appropriating municipal real estate property. Then the municipal council adopts a decision to delegate the right to manage this property to the new JSC. The JSC appreciates the municipal property in the capital of another commercial entity where it participates. This way, once apportioned to the joint stock company, the municipal assets are transferred to another company. In practice, the municipality is deprived of its property or does not receive any dividend. Although these operations are performed legally, the end result is a prolonged process of appropriations of properties, sales, and new appropriations.

Box 1.1

The Cases of “Sofia Property” and Park Management

The municipal company “Sofiyski Imoti” (“Sofia Property”) is a clear example of mismanagement and a misunderstanding of the purpose of PPPs. According to the audit report by the Agency for State Internal Financial Control, in 2004 the municipal budget of Sofia had lost “at least BGN 33 million from the participation in joint stock companies. This amount represents around 10 percent of the annual budget of the Sofia municipality.” OK, what happened? The company sold land and premises to private companies at very low prices and under very obscure and unfavorable conditions.

The management of municipal parks and green areas in Sofia municipality is another typical case. Many land plots within these parks have been issued municipal property deeds that depict them as private municipal property. In reality, these properties serve a public purpose and should be issued property deeds that describe them as public municipal property. Yet, as private municipal property, these land plots are subject to business transactions. As such, they are appropriated to the capital of a JSC or simply sold. All these transactions were approved by decisions of the municipal council. The municipality has a minority stake and no practical influence. Only seven hectares of park remain in Sofia’s South Park that have not been appropriated to a JSC “Sofia City Company.” Using the same approach, 3.5 hectares in the central part of Borisova Garden have been appropriated to another JSC. Again, the municipality has a minority share and no practical influence or control. Later the plots were transformed to construct residential areas or commercial facilities.

3.2 Examples of Concessions

The *concession* is a common approach to PPP, applied by Bulgarian municipalities. Data from the National Concessions Register show that for the last ten years (late 1997 through April 2008), 700 municipal concessions have been registered.

The prevailing aspect of the granted concessions is that they are defined as concessions for services. Over 400 municipal concessions are granted for *reservoirs and dams*. Under these concessions, the municipality transfers the right to manage a dam's municipal property for a defined period to a private entity. Typically, activities include fish farming and the provision of sport fishing services, in which case the concessionaire collects user fees.

Municipal concessions also involve the management of *sport and leisure facilities* (over 40), which include stadiums, swimming pools, and other recreation facilities. In some cases, the concession contract requires construction or rehabilitation of the object of the concession as well. Around 25 concessions have been granted for mineral waters; 23 for the extraction of construction materials; and 11 for road facilities (parking) and subways.

The municipal *water supply* and sewage services are sectors that are typically subject to public-private partnerships in EU member states. In Bulgaria, only two municipal concessions have been registered in the NCR for water supply and sewage networks—one of them in Sofia. The current government drafted a new law on water supply and sewage systems that will be submitted to the parliament soon. It is expected that the adoption of the new act will speed up the process of establishing PPPs by municipalities for the provision of this service.

More concessions are found in the field of *solid waste management* (15). The scope of services under these concessions usually includes collection, transportation, and disposal of solid waste and street cleaning or a combination of some of them. The possibility for attracting the private sector to waste treatment services is completely based on the policy of the respective municipality. In view of the limited finances and budgetary resources, the municipalities should be encouraged to enter into public-private partnerships in this sector. Yet, only one municipal concession for landfill construction is registered in the National Concessions Register.

About 200 concessions have been granted for providing other services—maintenance of green areas, management of kindergartens, provision of city transport services, etc.

4. SELECTED CASE STUDIES

4.1 A Swimming Complex in Blagoevgrad

Data on the concession:	Swimming complex
Concessionaire:	Akva Park Ltd.
Duration:	30 years
Investment:	BGN 3,000,000 ³

The municipality of Blagoevgrad has provided the right of usage of a swimming complex and other sport and recreation facilities, including the pertaining infrastructure and equipment, serving the swimming complex, to a concessionaire. The term of the concession is 30 years.

Prior to the concession, the municipality had partial ownership and operated an indoor swimming pool, which was in very poor condition, and a small outdoor swimming pool, which was practically unusable. The swimming pools are situated along the so-called “Alley of Health,” along the Bistrica River in Blagoevgrad. The alley is a very popular recreational area for the town’s citizens. Both swimming pools were in dire need of a major overhaul and significant investments. Academica JSC owned the swimming pools and the municipality owned the land (the land is public municipal property—12,700 square meters). Neither Academica JSC nor the municipality was willing to invest in them. In 2004 the municipality bought the swimming pools from Academica JSC for approximately BGN 100,000 BGN and gained full ownership of the asset.

The concessionaire selection process began with a decision by the municipal council in November 2004. The decision was made based on legal, economic, social, and ecological analyses prepared by the municipal administration. The terms of the concession set by the municipal council required minimum investments of nearly BGN 940,000 and a 20-year concession period. The exact amount of the investments and the investment period are determined by the investment project, which is subject to a tender.

By virtue of the contract, the concessionaire pledges to make investments at his own expense and in accordance with an approved investment program. The concessionaire provides free usage of the covered swimming pool to kindergartens, secondary, specialized, vocational, and high schools and universities. At the end of each year the municipality signs an annex with the concessionaire, stipulating the terms of use for the indoor swimming pool for the next year.

The municipal council set a requirement for the concession contract to guarantee to the municipality the following revenues from concession fees: 5.5 percent of the net revenues, but not less than BGN 20,418 for the first year; 8 percent of the net revenues, but not less than BGN 30,000 for the period from the second to the seventh year of the

concession; 12 percent of net revenues, but not less than BGN 40,000 from the eighth year to the end of the contract.

Based on the municipal council's November 2004 decision, the municipal administration organized a tender for selecting the concessionaire. In April 2005, the municipal council approved the selection of Akva Park Ltd., as the concessionaire for the swimming pools and authorized the municipal administration to sign a concession contract with the company. Akva Park Ltd., was the only company to submit an offer.

The approved offer was for an investment of BGN 7,000,000 in three stages. For the first phase, the proposed investment was BGN 3,000,000, which should have been completed by May 5, 2006. The proposal included construction renovation of the existing indoor swimming pool, construction of an Olympic-size outdoor swimming pool with stands, construction of a small swimming pool for children, several bars and a restaurant, a hotel, an underground parking lot, and several shops. A specific offer made by Akva Park Ltd., is an integral part of the contract, but has not been made available to the public.

In June 2006, the municipal council approved a 10-year extension of the concession contract, thus making the term of the concession 30 years. The specific reasons for the extension are not clear. In addition the new annex for the extension does not stipulate what the concession fees will be for the last 10 years of the contract, so it must be assumed that they will be unchanged. Data regarding this annex is not available in the National Concessions Register.

The initial experiences from this concession are very controversial. According to data provided by the municipality, as of December 2007, the municipality had encountered significant difficulties in managing the concession. An internal audit, ordered by the new mayor of the municipality indicated that these problems were inherited by the new municipal administration, which took office in September 2007. Most of the problems seem to have arisen from the lack of or inadequate post-privatization control on the side of the municipality. Some of the construction plans from the first phase of the investment—stands next to the Olympic-size pool, a main building with dressing rooms, a youth center, and sauna as well as the underground parking lot—have not been met. They have been postponed for phases *two* and *three* of the investment process, with approval from the municipality. The deadline for the completion of phases *two* and *three* of the investment is indefinite and has not been set.

In addition, the social aspect of the contract (free-of-charge usage of the covered swimming pool by schools, kindergartens, etc.) has hardly been fulfilled. Only a local university has used the swimming pool for six months. The municipal administration bears the fault for this, since it has not organized the schools and kindergartens and has not signed the necessary annex with the concessionaire.

Other significant problems with the concession are that the concessionaire has not insured the premises, as required by the contract. The concessionaire has not established

an adequate and transparent accounting system and the contractually mandated reports have not been provided to the municipality. Perhaps for this reason the concessionaire has been paying the minimum concession fees.

A short financial analysis of the economic effectiveness of the concession is presented in Table 1.1.

Table 1.1

A Short Financial Analysis of the Economic Effectiveness of the Concession
—Municipality of Blagoevgrad

Municipality of Blagoevgrad	Traditional investment: municipality implements the project with its own resources	Concession*
Life of the project	30 years.	30 years.
Initial investment	BGN 300,000	BGN 3,000,000 (under the concession agreement)
Repayment of loan	BGN 7,195,022	
Operational cost	BGN 3,086,371 (excluding indirect administrative costs)	BGN 0
Total costs: BGN 10,581,393		
Minimum revenues from concession fee	BGN 0	BGN 514,874
Revenues from user fees	BGN 10,287,903	BGN 0
Total financial benefits for the municipality	BGN –293 490	BGN 514,874

Note: * This analysis covers only the first stage of the investment, since it is the only one that is complete. The actual size of the total investment cannot be determined.

The analysis considers one alternative to the concession, where the municipality implements the project with its own resources. When implementing the project through a concession the municipality did not invest its own resources, rather it attracted external finances worth BGN 3,000,000. Through this approach the municipality did not incur operational costs or costs for repayments of loans.

The concession contract guarantees the following revenues from concession fees to the municipality: 5.5 percent of the net revenues, but not less than BGN 20,418 for the first year; eight percent of the net revenues, but not less than BGN 30,000 for the period from the second to the seventh year of the concession; 12 percent of the net revenues, but not less than BGN 40,000 for the period from the eighth year to the end of the contract.

In the alternative case, where the municipality implements the project with its own resources, the investment is again BGN 3,000,000. Since this is a considerable amount and can hardly be allocated from the municipal budget, a loan covering 90 percent of the investment (BGN 2,700,000) is foreseen for 30 years at an eight-percent interest rate. The remaining 10 percent of the investment (BGN 300,000) is covered by the municipal budget. Repayment of the loan requires 30 annual installments of BGN 239,834. The projected revenues are BGN 10,287,903 calculated on the basis of the minimum net revenues used for the calculation of concession fees. Operational costs are estimated at 30 percent of the net revenues, amounting to BGN 3,086,371. Since the concessionaire has not established an adequate and transparent accounting and reporting system, these are estimates. Under these estimates, the municipality stands to lose BGN 290,490 from the investment.

Based on this analysis and the fact that the municipality has guaranteed the free-of-charge use of the swimming pool for the schools and kindergartens, one should evaluate the concession as good and beneficial for the municipality. The problems in this concession stems not from the idea of establishing a PPP through a concession for the swimming pools, but rather from the specific contract that was signed and, more precisely, from the monitoring and reporting procedures that have not been established.

4.2 Development of Urban Areas: Burgas

Data on the concession:	City square for construction of underground parking lot
Concessionaire:	Global Technology Company JSC
Duration:	30 years
Investment:	BGN 20,000,000

In 2005, the municipal council of Burgas granted a concession for the right to develop a public square, an underground parking lot on three levels, including the infrastructure and equipment servicing the quoted objects, according to an approved design, which will be built by and with the concessionaire using its resources. The specified term of the concession is 30 years.

The concessionaire has the obligation to build the object of the concession, to undertake the construction of the underground parking lot and of the ground-level square area, including the technical infrastructure and belongings necessary for their usage, in compliance with the approved design. The public square area shall be urbanized and planted in order to form a city forum for the performance of cultural events, relaxation, and social contact with street lighting and church lighting. The concessionaire shall maintain the improvements for the term of the concession.

The amount of the concession payment is BGN 4,500,000, payable in equal annual installments, each one in the amount of BGN 150,000.

A short financial analysis of the economic effectiveness of the concession is presented in Table 1.2.

Table 1.2

A Short Financial Analysis of the Economic Effectiveness of the Concession—Burgas

Burgas	Traditional investment: municipality implements the project with own resources	Concession
Life of the project	30 years	30 years
Invested resources	BGN 20,000,000	BGN 20,000,000
Repayment of loan	BGN -47,966,814	
Operational cost	BGN 6,000,000	
Revenues from concession fee	BGN 0	BGN 4,500,000
Annual concession fee		BGN 150,000
Revenues from user charges	BGN 21,900,000	BGN 0
Total financial benefits for the municipality	BGN -29,066,814	BGN 4,500,000

When implementing the project through a concession the municipality does not invest its own resources, rather it attracts external finances worth BGN 20,000,000. Through this approach, the municipality does not incur operational costs or costs for the repayments of loans. After the thirtieth year, the municipality gains ownership of the asset.

The concession contract guarantees annual revenues from concession fees of BGN 150,000, increased each year with the level of inflation, to the municipality. Thus the revenues from concession fees are BGN 4,500,000

The municipality gains ownership of the asset after the thirtieth year. Making a very conservative assumption that the useful life of the asset is 50 years, and using straight line depreciation, at the end of the concession contract the municipality will receive a property worth BGN 8,000,000. The revenues from parking fees for 20 years are estimated at BGN 14,600,000, based on 400 parking spaces, occupied for five hours a day, 365 days per year and a parking ticket at BGN 1 per hour. But these revenues will go to the concessionaire. Annual operational costs are estimated at one percent of the investment cost—BGN 200,000, or BGN 4,000,000 for the 20-year period. Thus for a 50-year period the municipality stands to gain BGN 1,500,000.

In the traditional investment pattern, where the municipality implements the project with its own resources, the investment is again BGN 20,000,000. Since this is a considerable amount and can hardly be allocated from the municipal budget, a loan covering 90 percent of the investment (BGN 18,000,000) is foreseen for 30 years with an interest rate of eight percent. Repayment of the loan requires 30 annual installments of BGN 1,598,893. Thus the total cost of the loan (principal and interest) is BGN 47,966,814. The remaining 10 percent of the investment (BGN 2,000,000) are covered by the municipal budget.

Operational costs are estimated at five percent of the size of the investment—BGN 1,000,000. The projected revenues are projected at BGN 21,900,000, calculated the same way as above. Under these estimates, the municipality stands to lose BGN 29,066,814 from the investment for the 30-year period.

Based on these assumptions one can evaluate the concession as good and beneficial for the municipality. It must be noted that the actual useful life of the asset is probably 100 years.

4.3 A Youth Center in Gabrovo

Data on the concession:	Municipal land plot for construction of a social center for the youth
Concessionaire:	YMCA Gabrovo
Duration:	15 years
Investment:	BGN 344,308

In 2003, the municipal council of Gabrovo provided the use of a building and construction site that would house the Gabrovo Youth Center for the education of children, young adults, and the disadvantaged. The building is situated on a land plot that is public municipal property, which the municipality provides for 15 years (the duration of the concession). The concession was signed in accordance with a decision of the municipal council in March 2003. The decision was based on an analysis of the financial, economic, environmental, legal, social aspects of the potential youth center. The municipal council also based the decision on a prior decision in 2001, which required the preparation of the above-mentioned analysis and directed the municipal administration to find an appropriate land plot for such a youth center.

It appears that in 2001 and in 2003 there was a general agreement among the municipal councils and the municipal administration that there was a need for the establishment of a center that would provide training, education, and social activities, and organize events for youth and disadvantaged people. The six council committees

that reviewed the proposal for a concession—Urban Planning, Utilities and Transportation, Economy, Municipal Property, Restitution and Privatization, and Budget and Finance—approved the proposal. In addition to this, the shorthand record from the meeting of the municipal council indicates that all 23 councilors approved the establishment of such a center through a concession. The shorthand minutes do not show any opposition to the concession.

The municipal council set the procedure for selection of a concessionaire to tender in the presence of the contestants and in accordance of the Municipal Property Act (MPA). It must be noted that in 2003 it was Chapter 7 of the MPA that set the procedure for establishing municipal concessions.

The selected concessionaire was the YMCA Gabrovo. According to the contract, the concessionaire would prepare, at his own expense, the design of the object of concession, according to a schedule, coordinated with the grantor of the concession. The concessionaire would also develop and present to the municipality a complete investment schedule by month for the building and equipping the center, as well as for improvements to the area belonging to the concessionaire. The concessionaire also agreed to perform only those commercial activities expressly described in the contract. The value of the investment is estimated at BGN 150,000–300,000 for construction and BGN 150,000 for equipment and for furnishing the premises.

The annual concession fee is set at BGN 240 payable in one installment. The first installment is due in the month after concession object operation begins, and the installment for each subsequent year—up to January 31.

The initial concession experiences were generally positive. The property was well maintained. The due concession fees were paid regularly and in time, as was evidenced in the National Concession Register.

According to Nikolaj Sirakov, Gabrovo Municipal Secretary, the quality of the service is good. The organization is active and organizes many events and trainings for youth. This is also evident on the center's web site.⁴ In March 2007, the center was chosen by the National Agency for Youth and Sports as a regional Youth Information and Consultancy Center.

The only negative signs related to this concession were from a report by the Regional Audit Office in November 2007. The report made 16 recommendations to the municipal administration, one of which was to increase the concession fee between the YMCA and Gabrovo municipality. The municipality did not follow the recommendation due to contractual legal obstacles. Apparently, the contract does not provide for concession fee increases or adjustments for inflation.

A short financial analysis of the economic effectiveness of the concession is presented in Table 1.3.

Table 1.3
A Short Financial Analysis of the Economic Effectiveness of the Concession
—Gabrovo Municipality

Gabrovo municipality	Traditional investment: The municipality implements the project with own resources	Concession
Life of the project	15 years	15 years
Invested resources (actual)*	BGN 172,154	BGN 344,308
Repayment of loan	BGN –301,690	BGN 0
Operational cost	BGN 40,000	
Revenues from concession fees	BGN 0	BGN 2,331
Annual concession fee	BGN 0	BGN 240
Book value of the asset after the fifteenth year	BGN 241,016	BGN 241,016
Revenues from rents	BGN 360,000	BGN 0
Total financial benefits for the municipality	BGN –113,844	BGN 2,331

Note: * The current analysis is a modification of the financial and economic analysis, prepared by the municipal administration, in that it accounts for the actual cost of the investment—BGN 344,308.

The analysis considers one alternative to the concession, where the municipality implements the project with its own resources.

When implementing the project through a concession the municipality did not invest its own resources, rather it attracted external finances worth BGN 344,308. Through this approach the municipality did not incur operational costs or costs for repayments of loans. After the fifteenth year, the municipality gains ownership of the asset.

The concession contract guarantees annual revenues from concession fees of BGN 240, which are not indexed with the levels of inflation, to the municipality. The analysis incorporates a six percent level of inflation for the entire 15-year period with which the expected revenues are decreased. Thus, the revenues from concession fees, reduced with projected inflation, are BGN 241,016.

Since the municipality gains ownership of the asset after the fifteenth year, the analysis needs to take into consideration the book value and the potential revenues after the fifteenth year. The property is a two-story building with a total area of 285 square meters. On the first floor there are two halls used for meeting and working with the disabled children and a confectionary/pastry shop. Administrative offices are located on the second floor. Thus, if after the fifteenth year the municipality wishes to maintain the function of the building, the only revenue from the property will be from renting the confectionary/pastry shop.

Making a very conservative estimate that the useful life of the asset is 50 years and using straight line depreciation, at the end of the concession contract the municipality will receive a property worth BGN 241,000. With a monthly rent of BGN 2,000, the municipality will earn BGN 840,000 for the 35-year period after the concession.

In the alternative case, where the municipality implements the project with its own resources, the investment is again BGN 344,308. A loan covering 50 percent of the investment (172,154 BGN) is foreseen for 15 years at an interest rate of eight percent. The remaining 50 percent of the investment is covered by the municipal budget. Repayment of the loan requires 15 annual installments of BGN 20,112. The projected revenues are BGN 360,000 calculated the same way as above. With these assumptions the municipality stands to lose BGN -113,844 from the investment for the 15-year period.

Based on these assumptions one can evaluate the concession as good and beneficial for the municipality.

There are non-financial benefits from the concession which have not been calculated in the financial and economic analysis. The analysis estimates that the number of people who will benefit directly from the concession are 16,500 annually and 2,500–5,000 will benefit indirectly. Thus, the total number of people benefiting from the project is between 19,000 and 21,500 annually, under both options.

The prepared financial and economic analysis on which the municipal council bases its decision does not look at alternative properties for the construction of the center. It also does not consider the value of the land on which the property is built (the land plot is 1,735 square meters), because it was not sold, just rented.

4.4 Water Supply and Sewage in Sofia

The concession for the water supply and sewage services of Sofia municipality was granted by virtue of a contract in 2000. It was the first municipal concession in this sector. In 1989, Sofia registered a municipal enterprise, “ViK” (ViK—water supply and sewage system), with the purpose of: the design, maintenance, operation, and reconstruction of the water supply and sewage system; engineering activities related to the maintenance of the ViK network; management of mineral waters and mineral springs; design, construction, reconstruction, and maintenance of river beds in the territory of Sofia municipality.

In 1997, the enterprise had been re-registered as a sole-proprietor stock company “ViK Sofia” with the same purpose. Since October 2000, the joint stock company “Sofiyska Voda” had provided water supply and sewage services in Sofia. This was done under the provision of a concession contract between Sofia and the company for 25 years. Company owners include Sofia municipality and “International Water,” a British operator. The purposes of the company are to operate the ViK networks and to undertake investments.

The value of the investments in the first 15 years of the concession contract is around USD 152 million. In 2003, “International Water” transferred its share to “United Utilities” and the European Bank for Reconstruction and Development (EBRD). Currently, the shares of the company are divided between Sofia municipality (25 percent) and United Utilities/EBRD (75 percent). The ViK service covers over 1.5 million inhabitants and the company is responsible for the operation, maintenance, and the management of 4,077 kilometers of water mains and 2,086 kilometers of drains, and two wastewater treatment plants. The company has 1,000 personnel.

4.4.1 Procedures for the Selection of the Concessionaire

In 1998, the municipality of Sofia contracted PriceWaterhouseCoopers to prepare an analysis and an informational memorandum about the status of the water supply and sewage system in Sofia.

That same year, the municipal council of Sofia adopted a decision for the procedural launch of a two-stage competition that would grant a concession for the provision of municipal water supply and sewage services. The competition was carried out according to the municipal ordinance on concessions that was in place at that time. The council’s decision did not contain one of the ordinance’s requisites—the type, amount, and method of payment for the concession price.

The competition was carried out in two rounds—a prequalification (preliminary selection of candidates) round and a final round. Eight international companies applied and four companies were short-listed for the second round. The commission ranked “International Water Limited” first, “Lyonnaise des Eaux” second, and “Vivendi/Marubeni” third.

One year later, in November 1999, the municipal council of Sofia approved the report of the selection commission, and announced “International Water Limited” as the winner and authorized the mayor to negotiate and sign a contract for the granting of a concession within one month.

“International Water Limited” established and registered a joint stock company named “Sofijska Voda” with its headquarters in Sofia.

The concession contract was signed in December 1999 between the Sofia municipality (the grantor) and “Sofijska Voda” (the concessionaire—in the process of registration). The concession term was 25 years. The contract became active in October 2000, after the signing of protocols for the fulfillment of the preliminary conditions, listed in the concession contract.

4.4.2 Contractual Obligations

According to the provisions of the concession contract, “Sofiyska Voda” was obligated to provide a performance guarantee in the amount of USD 750,000 to the municipality of Sofia on the date of the contract’s activation. The amount was to be deposited in an internationally recognized bank whose long-term loans were evaluated to at least a AA Standard and Poors rating or a comparable rating by Moody’s Investment Services. The performance guarantee was valid for a minimum period of 12 months and could be renewed or changed by the concessionaire in terms that would guarantee the municipality access to the funds at any time during the contractual period.

In December 2000, a loan agreement was signed between “Sofiyska Voda” and the EBRD for a loan in the amount of EUR 31 million. One of the conditions for entering into the loan agreement was the provision of a guarantee on behalf of the municipality. Such a guarantee was signed between Sofia and the EBRD. The municipality guaranteed, unconditionally and unavoidably, the obligation of payment of all sums due by “Sofiyska Voda” under the loan agreement with the EBRD in case “Sofiyska Voda” failed to meet the terms of the agreement. Thus, the municipality became a debtor to the bank.

The two contracting companies agreed to an initial list of private assets owned by the municipality’s company, “Vik.” These assets would become capital for the joint stock company “Sofiyska Voda,” to be used against shares. The municipal council adopted two decisions (July 2000 and April 2002), and approved the transfer of the assets of the sole proprietor municipal company “ViK” for the purpose of acquisition of shares at nominal value from the capital of the concessionaire. The transferred assets of the municipal company account for BGN 4,889,295.

The fees for the water supply and sewage service and their review, corrections, and indexation are regulated by the concession contract. Basic prices are determined in an annex to the contract, and they shall apply for each of the first three years of the contract. The price of the service is calculated based on basic prices, indexed, and corrected during annual reviews. Indexation and corrections are carried out following a methodology explained in the financial model. (Different fees are set for drinking water, industrial water, sewage, and wastewater treatment. Fees are differentiated by groups of users (households, budgetary organizations, commercial entities.)

The price increase for users between the initial and the final period is from 28 to 34 percent.

4.4.3 Monitoring of the Concession Contract

In accordance with the contract provisions and the agreement reached between the parties, the municipality initiated a procedure for the selection of a concession monitoring

body. The municipality announced a competition for the selection of an expert team to perform the overall monitoring of the concession contract. One candidate applied and the municipality signed a five-year contract with Omonit Ltd.

The main responsibilities of the consultant are to prepare expert contract performance analyses and recommendations for solving arising issues, and to submit periodic and annual reports to the municipal council. Reports include standard service performance analyses; implementation of the investment program; an explanation of cases where performance standards are not met, and the calculation of sanctions; and financial monitoring and users' claims.

Concession activities are managed and overseen by the mayor of the municipality.

The concession contract contains an annex regulating the sanctions in case performance standards are not met. For the period between 2001–2003, the mayor of Sofia imposed sanctions in the amount of BGN 263,000 for performing below standards; “Sofiyska Voda” paid the fines.

4.5 A Complex Local Development Project in Sevlievo

A good practice of a very successful partnership between a municipality and the private sector is evident in the municipality of Sevlievo. The municipal leadership and the private companies operating on the territory of Sevlievo negotiated a partnership agreement and registered a nonprofit association “Sevlievo 21st Century.” The main objective behind the partnership was to involve private resources in municipal development.

The objectives of the partnership are to contribute to the social and economic development of the municipality, to increase the living standard of the citizens of Sevlievo municipality, and to provide opportunities for young people to stay and work in Sevlievo. Members of the association are the local government and more than 40 small, medium, and large enterprises in the territory of the municipality. The management of the association is performed on a voluntary basis. The municipality and the businesses work together on municipal priorities, develop annual action plans, and undertake actions for the achievement of the partnership's objectives. Areas of intervention include a broad range of sectors—health, social assistance, culture, sport, and others.

Some of the achievements of the partnership “Sevlievo 21st century” financed or co-financed by the businesses include:

- a) provision of a microbiology laboratory and an X-ray apparatus for the municipal hospital;
- b) improvement of the living conditions (furniture and equipment) in the municipal social assistance establishments—for elderly people and for children with special needs;

- c) restoration of historical monuments and the church in Sevlievo;
- d) building of a new movie theater;
- e) organization and sponsorship of many cultural events—concerts, performances, exhibitions, competitions among children, etc.;
- f) reconstruction of sports facilities, including building a swimming pool and the rehabilitation of the city stadium;
- g) sponsor the municipal sport clubs for samba, judo, and volleyball;
- h) construction of playgrounds in the city park;
- i) provision of financial resources for the performance of the local football team;
- j) introduction of measures for road traffic safety.

The keys to the success of “Sevlievo 21st Century” are the commitment of all partners to work for the achievement of the partnership’s objectives, the clear procedures for the implementation of the activities, and the clear roles of the partners.

The case illustrates how public and private sector expertise and financial resources can be mixed to create a strong operational partnership in the interest of all citizens in the municipality. Unfortunately, there is no detailed information or comparative literature available about this PPP.

5. RECOMMENDATIONS

Recommendations derived from our findings mostly focus on the regulatory changes and the measures to be taken by local governments.

Transparency of joint stock companies

The establishment of joint stock companies, as mentioned earlier, is made in a non-transparent manner, ignoring the public interest. The establishment of such companies should be preceded by a large public discussion as part of an adopted municipal policy on a public-private partnership. The decision to register joint stock companies should be based on the principle of economic efficiency and profit gains, thus ensuring additional resources to the municipal budget.

Provisions of Concession Act should be adjusted to local conditions

One of the concession’s legal framework deficiencies regarding the municipalities is that the Concession Act does not allow individual municipalities to adopt local regulations that “adapt” the Concessions Act to their specifications. Instead, a centralized approach

has been chosen by adopting the Rules on the Application of the Concession Act. These rules provide for unified regulation of all the public bodies that grant concessions, including the municipalities. The Concession Act could be amended to give the municipalities the opportunity to apply their own policies regarding the concessions within the framework of the Concession Act. Municipal councils should adopt ordinances on concessions where the rules and the procedures for granting municipal concessions should be specified, taking into account local specifications.

Need for local strategy on municipal property management

Municipal councils could initiate a public debate and adopt a municipal property management strategy after consultations with stakeholders. The strategy should define the municipal policy for the management of the municipal property, and outline the local government's commercial activities objectives. Regarding concessions, the strategy should include the main characteristics of municipal real estate properties that will be subject to concession contracts. Based on the adopted policy, municipal councils should adopt annual programs for the management and disposition of municipal property. The program should be adopted before the annual municipal budget and the section on concessions should contain forecasts of expected income and expenditures, as well as a description of the municipal assets for which the local government intends to grant concessions.

Local policy on public-private partnership should be developed

The Bulgarian municipalities do not have policies on PPP. The ordinances on the management of municipal property, on establishing commercial companies, etc., are all local regulations for specific procedures. But there are issues unique to PPP that relate to the strategic municipal objectives in infrastructure financing and service provision. Therefore, it is advisable that municipal councils adopt a decision laying down the municipal policy on PPP. Obviously, the scope and the content of such a formal document will vary from municipality to municipality. Some local governments may adopt policies that do not promote public private partnership as an option of service delivery or may have a restrictive policy on some types of PPP. Others may encourage the PPP in building infrastructure and providing services in both institutionalized and contract-based types of PPP.

In any case, the principles and considerations should include such issues as the type of services or projects; the forms of PPP that will be considered; the degree of risk the local government is ready to accept and the risks it is not prepared to accept; positions on conflict of interest for those involved in the PPP; procedures for involving the local community in the process; interrelations with other municipal policies, including finance, environment, employment; types of partners; as well as fundamental principles such as transparency, accountability, and fair competition.

Approved local policies will have a number of advantages for both the local government and the local community. They will provide a clear message about the public's interest when entering into public-private partnerships. In addition, they will facilitate and guide decisions when considering PPP agreements. The document should specify the principles, the rules and the procedures for the execution of PPP contracts, ensuring optimal usage of the municipal financial resources and long-term tangible assets and protecting the public interest. A few larger municipalities (Sofia, Plovdiv) have initiated the adoption of a municipal ordinance on PPP. A few Bulgarian municipalities have also adopted an ethical code for work with private businesses.

Clear assignment of responsibilities for PPP projects

Once the local government has a clear policy on public-private partnerships, it should identify who within the municipality will be responsible for the PPP. Although the municipal council has the ultimate authority, the municipal administration and service departments initiate or review public private partnership initiatives before they are brought to the council. Given the fact that PPP may be applicable to different types of municipal services and that the PPPs require specific expertise, it is advantageous to assign the functions of the public private partnership to a single department or individual within the municipal administration, and to one standing committee of the municipal council.

This will lead to benefits like, ensuring a consistent municipal policy on public private partnership; concentrating expertise, capacity, and support within the local government; making the lines of responsibilities clear; establishing a single point of contact for private sector interests; and improving the coordination of PPP activities for different service departments.

APPENDIX

Data on Concessions in the National Register

1. Body having conducted the procedure for selection of a concessionaire—name, address
2. Type of concession
3. Location of the object of the concession
4. Individual description of the object of the concession
5. Description and scope of services and/or economic activities, which the concessionaire is entitled to perform in connection with the object of the concession
6. Type of procedure and circumstances that justify its application
7. The name and nationality of candidates admitted to participation in the restricted procedure and in the competitive dialogue and the reasons for their admission
8. The name and nationality of the participant rated as the first choice, and the reasons for the selection
9. The name and nationality of other participants in the procedure and an explanation of their evaluations
10. The value of obligations of the concessionaire for:
 - a) construction
 - b) other investments
 - c) management costs
 - d) operational costs
11. The date of termination of the procedure
12. The reasons for termination of the procedure

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- UNDP (2006) *Assessment of Municipal and District Capacities for Participation in EU Structural and Cohesion Funds Absorption*. Sofia: UNDP.
- Ministry of Finance (2009) *Municipal Budgets Database*. Sofia: MoF.
- (2006) *Methodological Guidelines for Public-Private Partnerships*. Sofia: MoF.
- National Concessions Register. Available online: <http://www.nkr.government.bg/app>.

NOTES

- ¹ Public municipal property is the real estate and goods, specified by an act; the real estate, provided for the execution of the functions of the local government and the local administration; other real estates, specified by the municipal council assigned for the long-term satisfaction of public needs. Private municipal property is all other municipal real estate and goods. The private municipal property, in contrast to public municipal property, is subject to business transactions.
- ² Available online: <http://www.nkr.government.bg>.
- ³ BGN 1 = EUR 0.5.
- ⁴ Available online: <http://gb.mikc.bg/>.

Public-private Partnerships in Croatia

Institutional Framework and Case Studies

Dubravka Jurlina Alibegović

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EXECUTIVE SUMMARY

This paper focuses on the legal and institutional framework for public-private partnerships in Croatia where, in the last few years, there have been a handful of examples of local and regional government units that have shown a great deal of enthusiasm in discovering novel ways of financing capital projects. Two successful cases of contractual public-private partnerships at the local level are analyzed here, the case of the city of Varaždin and its surrounding county attempting to finance, build, and operate the expansion of its schools and sports facilities, and likewise the city of Koprivnica's school building program, though not all cases have been so rosy and positive for PPPs in Croatia.

Although the institutional framework for public-private partnerships in Croatia was only properly established in 2006, Croatian practice has shown a number of successful public-private partnership projects at the national and local levels. When Croatia began setting up the institutional and legal framework for public-private partnerships in 2006, guidelines adopted that year for the implementation of contractual forms of public-private partnerships regulated only contractual public-private partnerships and not institutional ones. The Public-private Partnership Act was introduced in late October 2008, and a new Agency for Public-private Partnerships was registered on December 21, 2008, and it officially opened its doors on January 8, 2009. More specific regulations on contracts, timing, structure, supervision, and even capacity building relevant to the management and monitoring of both infrastructure and provision of service PPPs followed in 2009, highlighting the ultimate authority of the Ministry of Finance in approving these contracts.

For Croatian local governments, public-private partnerships represent a relatively new opportunity for securing the necessary funds to construct important urban facilities, having already played a prominent role in the construction of major highways in Istria and Dalmatia and a water purification system in the capital, Zagreb. So far, it has been a lack of public budgetary funds and limits on borrowing and debt that have been the predominant reason for local governments involving the private sector in local and regional investment and development projects. To illustrate two positive outcomes, two local self-government units were chosen for inclusion here as successful examples of how to establish new revenue sources to finance urban investment projects.

The city of Varaždin has been a pioneer in implementing local development strategies, applying a mainly bottom-up approach. The city of Varaždin and Varaždin County were the first cases in which new models for financing the construction of schools and the reconstruction of the County Palace were put into practice in Croatia. The city opted for a public-private partnership, build-operate-transfer (BOT) model. Private partners financed the construction and maintenance of public buildings owned by the city and county, while the city and county agreed to pay their private partner's monthly fees over a period of 20–30

years. So far, the cost-effectiveness and quality have met expectations and continue to the time of writing.

Meanwhile, the city of Koprivnica is important here, since it has not prepared any local strategic document. However, this fact has not decreased the local government's interest in using a public-private partnership to finance the construction of a new school. The city of Koprivnica decided to implement a BOT model and was surprised to meet its own planning deadlines for the completion of the school.

Several important conclusions can be drawn from these two case studies. The preparation of a strategic development document at the local and regional levels is essential for recognizing strategic priorities. This development document is also a tool for applying and receiving EU funds and should also be coordinated in conjunction with the local budget, for parallel adoption of a strategic program and a budget is essential.

Yet local and regional self-government units in Croatia still share the problem of inadequate financing. The practice of the selected case studies shows that local budgets are not the only source of revenue for the financing of urban development projects. Because of a lack of public funds, the private sector's involvement in the financing of local and regional investment projects is necessary. Apart from this, there are several other reasons for private sector involvement in the financing of urban projects: increased local and regional needs, the inadequate structure of local and regional revenue models, the size of local and regional development projects, and limitations on debt financing at the local and regional levels.

Public procurement and other forms of contracting are the tools of modern local government, creating value for money and reduced fiscal risk. Local economic development depends on a reasonable balance between the public and private sectors at the local level and the use of private sector methods in local public management, keeping in mind that size and scale are a very important factor in considering the costs and returns of PPPs. It is under the rubric of widespread decentralization, even in a state that tends to centralization like Croatia, that such initiatives can flourish and finance capital projects.

1. INSTITUTIONAL FRAMEWORK

1.1 Introduction

In the last several years, there have been a number of examples of local and regional government units that have found new ways to finance capital projects, both inside and outside the framework of local strategic documents.

Local strategic documents have been developed at the local and regional levels in Croatia, introducing a participative approach in planning development practices. There are different practices involved in implementing local strategic documents, particularly with regard to their coordination with budget planning, including capital investment planning, and in overseeing performance results (Kelly and Rivenbark 2003; Shah 2007).

Local governments all over the world face the problem of inadequate financing. The structure of expenditures in local budgets everywhere demonstrates that current expenditures prevail. For the purpose of economic development, however, expenditures must be structured entirely differently.

In order to secure appropriate funds for capital purposes, municipalities and towns must have the following:

- The skills and necessary information to budget for the current and coming years (including both operating and capital budgets).
- The ability to identify, prioritize, and plan capital investments.
- The ability to compare different options for financial capital investments (including budget financing, borrowing, issuing municipal bonds, or using a public-private partnership).
- The ability to understand the impact of borrowing on capital investments—both annual debt service and annual operational and maintenance expenditures.

A lack of public funds is the predominant reason for the private financial sector's involvement in local and regional investments and development projects. Apart from this, there are several other reasons for the private sector's involvement in the financing of such projects:

- Increased local and regional needs;
- Inadequate structure of local and regional revenues;
- The size of local and regional capital projects;
- Limitations on borrowing at the local and regional levels (Alibegović 2007a); and
- Improvement in management practices and technology transfers.

Municipalities and towns must be able to identify and analyze all their technical and financial options, and to assure private investors that they have sufficient, reliable revenues to meet their debt service obligations (Kandeva 2001).

This paper focuses on the legal and institutional frameworks for public-private partnerships in Croatia. In this paper two cases of public-private partnerships at the local level are examined. The selected local self-government units have been chosen as examples of the successful use of new revenue sources for the financing of urban investment projects.

The major characteristics of public-private partnerships are specified in the second part of this paper. Short explanations of current legal and institutional frameworks for public-private partnerships in Croatia are given in the third part of this paper. The fourth part of the paper investigates two Croatian cases of public-private partnerships at the local level. The last part of the paper provides key conclusions and recommendations to be drawn from the analyzed examples.

1.2 Public-private Partnerships

A public-private partnership is a partnership established between the public and private sectors for the purpose of delivering a project or a service traditionally provided by the public sector. Public-private partnerships recognize that each sector has certain advantages in the performance of certain specific tasks. By allowing each sector to do what it does best, public services and infrastructure can be provided in the most economical and efficient manner.

Regarding the aforementioned definition, it is important to note that the most important role of a public-private partnership is to serve as a new model for the financing of capital projects.

There are several public-private partnership models, and variations and combinations of them may be defined by the local authority undertaking an infrastructure project.

The Build-Operate-and-Transfer (BOT) model, one of the better-known models, is a contractual arrangement whereby a developer undertakes the construction of a given infrastructure facility, including financing, and oversees its operation and maintenance. The developer operates the facility over a fixed period of time and in order to enable recovery of the project investment is entitled to charge users of the given facility the appropriate tolls, fees, rent, and other charges, which are not to exceed those proposed in the bid or negotiated and incorporated in the contract. The developer transfers the facility to the government, government agency or local authority at the end of the fixed term specified in the concession agreement. This incorporates a supply-and-operate agreement, i.e., a contractual arrangement whereby, should the government, government agency, or local authority require the supplier of equipment and machinery for an

infrastructure facility operates that facility while providing the appropriate training to designated individuals in the process of transferring the technology to the government, government agency, or local authority.

The selection of one particular model depends on the length of participation by the private partner in the project, the type of compensation to the private partner for participation in the project, the private partner's participation in making a profit, and the level of private sector autonomy in setting the price for services rendered.

There are several interested partners in a public-private partnership; these include: the public (especially consumers), building contractors, operators, maintenance services and suppliers, loan capital providers, investors, and insurance companies.

A public-private partnership holds the promise of increasing the supply of infrastructure projects and other services without overburdening a country's public finances. An inflow of private capital and management can ease fiscal constraints on infrastructure investments and boost their efficiency.

However, public-private partnerships must be employed with great care. They are undoubtedly more efficient than traditional public investments. Public-private partnerships can be used to move investments off the budget and debts off the government's balance sheets. However, the government continues to bear most of the risk, and potentially faces great costs that could be borne by taxpayers.

The "risk matrix" consists of three different groups of risks: construction, availability, and demand risks.

If public-private partnerships aim to deliver high-quality, cost-effective services to consumers and the government, there must be an adequate transfer of risk from the government to the private sector. The quality of services must be part of the contract, so that payments to service providers can be linked to performance, and the risk of costly contract regeneration may be minimized. There must either be competition or incentive-based regulations (Hemming and Ter-Minassian 2005).

In Croatia, there are only a few examples of public-private partnerships. Most of these involve concession agreements for the construction of highways in Istria and Dalmatia. The BOT model is also an excellent example of a public-private partnership model used in Croatia, mostly in various infrastructure projects (for example, the water purification system in the city of Zagreb).

1.3 Legal and Institutional Framework

The legislative framework for public-private partnerships in Croatia consists of the following documents:

- The Guidelines for the Implementation of Contractual Forms of Public-private Partnerships (*Official Gazette* 98/06);

- The Government of the Republic of Croatia's Decree on Preliminary Consent to a Public-private Partnership Contract Based on the Private Financial Initiative Model (*Official Gazette* 20/07); The Budget Implementation Act for 2009 (*Official Gazette* 149/08);
- The Public-private Partnership Act (*Official Gazette* 129/08);
- The Regulation on the Criteria for Assessment and Approval of PPP Projects (*Official Gazette* 56/09);
- The Regulation on the Content of Public-private Partnership Contracts (*Official Gazette* 56/09);
- The Regulation on the Supervision of Implementation of PPP Projects (*Official Gazette* 56/09); and
- The Regulation on Training of Participants in the Procedures for the Preparation and Implementation of PPP Projects (*Official Gazette* 56/09).

The Guidelines for the Implementation of Contractual forms of Public-private Partnerships (*Official Gazette* 98/06) define a public-private partnership as a form of cooperation between public and private partners aimed at ensuring financing, construction, reconstruction, management, infrastructure maintenance, and the provision of public services.

The Government of the Republic of Croatia's Decree on Preliminary Consent to a Public-Private Partnership Contract Based on the Private Financial Initiative Model (*Official Gazette* 20/07) sets forth the necessary elements of an application for preliminary consent, all the required enclosures, and the manner of reporting on the implementation of such contracts.

The Budget Implementation Act for 2008 (*Official Gazette* 28/08) sets the limits for concluding public-private partnership contracts at the municipal, town, and county levels, according to the private financial initiative model. A public-private partnership contract may be awarded if the total annual amount of all charges paid by the public partner to private partners pursuant to all public-private partnerships contracts does not exceed 35 percent of the budget revenue realized in the previous year, decreased by capital income, and only with the prior consent of the Ministry of Finance and the line ministry or public administration body in whose competence the subject of the contract lies.

The Budget Implementation Act for 2009 (*Official Gazette* 149/08) does not explicitly mention public-private partnership nor explicitly sets limits on annual fees on public-private partnership contracts at the state, municipality, town, and county levels.

In late October 2008, *the Public-private Partnership Act* (*Official Gazette* 129/08) was set up. The new act replaces the Guidelines and the Government Decree. The Public-Private Partnership Act regulates:

- preparation, nomination, and acceptance of public-private partnership project proposals;
- rights and obligations of public and private partners; and
- establishment and competences of the Agency for Public-private Partnership.

According to this new act all public-private partnership project proposals should be financially sustainable and harmonized with:

- budget projections and fiscal risks and limitations;
- sectoral development plans and strategies; and
- local development policies (local development strategies).

The most important rights and obligations of public and private partners are defined in the public-private partnership contract. The law defines the duration of such contracts (between 5 and 40 years).

The procedure for the proposing and approval of PPP projects is given in the next several paragraphs.

By law, public bodies are the only ones authorized to propose the implementation of a PPP project.

Before a proposal is adopted by the Agency for Public-private Partnership within the government, *the Regulation on the Criteria of Assessment and Approval of PPP Projects* will establish the professional criteria for the assessment and approval of PPP projects and a list of the documents to be submitted with the project proposals.

The public body shall submit the project proposal and the accompanying documentation laid down in the *Regulation on the Criteria of Assessment and Approval of PPP Projects* to the Agency for Public-private Partnership.

The Agency for Public-private Partnership shall evaluate the contents of the project proposal in line with the criteria laid down in the regulations. It will seek consent from the Ministry of Finance with regard to the project proposal's compliance with the budgetary forecasts and plans, fiscal risks and limitations stipulated in special regulations, and with regard to the financial and fiscal viability of the project proposal. The Agency shall also seek the opinion of the competent line ministry as to the compliance of the project proposal with development plans and strategies, i.e., regulations relating to its area of competence.

The competent local and regional self-government units shall submit their opinions as to the compliance of the project proposal with the development policy plans of these local, i.e., regional self-government units to the Agency for Public-private Partnership, at its request.

Within a period not exceeding 90 days from the day when the project proposal and the entire accompanying documentation are submitted, the Agency for Public-private Partnership shall adopt a decision on the approval of the implementation of the proposed project under one of the PPP models.

The project proposal shall acquire the status of a PPP project solely on the basis of a decision by the Agency for Public-private Partnership. A public body may adopt a decision on the implementation of the project under one of the PPP models solely on the basis of the previously obtained decision of the Agency.

Prior to initiating the procedure for the selection of a private partner the public body shall submit copies of tender documents and all accompanying annexes to the Agency for Public-private Partnership for assessment and approval. The Agency shall issue a decision on document compliance with the approved proposal of the project within a maximum of 30 days from the date that it receives the complete set of documents.

Prior to reaching a decision on the selection of the private partner, the competent public body shall submit the final draft of the PPP contract, including all the annexes to the Agency for Public-private Partnership for approval, and shall also obtain consent from the Ministry of Finance for the final draft of the contract.

Within 30 days from the final draft date of receipt, the Agency for Public-private Partnership shall reach a decision on the granting of consent to the text of the draft contract. The Agency for Public-private Partnership shall issue the decision on the basis of the assessment of compliance of the draft contract with the tender documents and the provisions of *the Regulation on the Content of Public-Private Partnership Contracts*. The PPP contract may be completed solely on the basis of a decision by the Agency for Public-private Partnership and the consent obtained from the Ministry of Finance for the final draft contract.

The selection procedure of the private partner shall be carried out in accordance with the regulations on public procurement. If the implementation of the PPP project presupposes the granting of a concession, the selection procedure of the private partner shall be carried out in accordance with the regulations on the procedure for the award of a concession.

The Regulation on the Criteria for Assessment and Approval of the PPP Projects (Official Gazette 56/09) establishes the criteria and procedure for the assessment and approval of public-private partnership project proposals, the criteria for assessment and approval of tender documentation, and the criteria for assessment and approval of the final draft of public-private partnership contracts.

The Regulation on the Content of Public-private Partnership Contracts (Official Gazette 56/09) lays down the minimum content of public-private partnership contracts. The public-private partnership contract is a basic contractual agreement between a public

and a private partner, or a public partner and a Special Purpose Vehicle (SPV) which, for the purpose of implementation of the public-private partnership project, regulates the rights and obligations of the parties to the contract.

The contract, the subject matter of which is the provision to the final beneficiaries of public services falling within the scope of the public partner, shall contain at least the following: preamble, contracting parties, definition of terms, purpose and subject-matter of the contract, duration of the contract, property rights of contracting parties, distribution of risks and related expenses, financial guarantees, contracting parties' payments, events which may cause damage and the manner in which contracting parties should proceed in the case of damages, insurance policies, consequences of failure to fulfill contractual obligations, the right of supervision by the public partner, *force majeure*, termination of contract, environmental protection, sending notifications during the contracted period, protection of intellectual property, business secrets and confidentiality of data, service quality standards, subcontracting, settling disputes resulting from the contract, severability provisions, and forced entry into the contract. The annexes cover: standards of services, risk distribution matrix, decision on the selection of the most advantageous tenderer, excerpt from the court register and statute of the private partner, contract performance guarantee, parent company SPV guarantee, private partner's operating plan.

The Regulation on the Supervision of Implementation of PPP Projects (Official Gazette 56/09) governs the authorizations of the Agency for Public-private Partnerships concerning the supervision of implementation of public-private partnership projects, practice in the course of supervision of implementation of PPP projects, as well as the rights and obligations of the contracting parties in the process of supervising PPP project implementation.

The Regulation on Training of Participants in Procedures for the Preparation and Implementation of PPP Projects (Official Gazette 56/09) lays down the training program in the field of public-private partnerships, the persons for whom the training shall be provided, the organization and manner in which training will be implemented, an acknowledgement of training completion, and a certificate for the completed training program.

Before the Agency for Public-private Partnership was established, the Trade and Investment Promotion Agency was a government agency whose main task was to provide full service to investors during and after the implementation of their investment projects. The Public-private Partnership Unit of the Agency was in charge of all PPP issues. Particular responsibilities of the unit included controlling the tendering and contractual documentation, managing the proposed distribution of risks and other elements of PPP contracts (which define leasing), and reviewing the documents submitted to confirm that a PPP project was defined under the leasing principles.

The Public-private Partnership Act was adopted by the Croatian Parliament on November 24, 2008, and after the publication of the adopted Act in the *Official Gazette* 129/08, the Agency for Public-private Partnership was registered on November 21, 2008. The government of the Republic of Croatia adopted the decision to appoint the governing board of the Agency, and on January 1, 2009, the Agency began its work as the legal successor to the previous sector in the Trade and Investment Promotion Agency.

The new legislation defined numerous tasks for the Agency for Public-private Partnership. The Agency is the central national body in charge of the implementation of the Public-private Partnerships Act in the Republic of Croatia. The basic tasks and authorities of the Agency include:

- Approving public-private partnership project proposals, tender documents, and the final draft contract;
- Publishing the list of approved PPP projects and presenting it to potential investors;
- Organizing and keeping the register of PPP contracts;
- Supervising the implementation of PPP contracts;
- International cooperation with the purpose of advancing the theory and the practice of PPP;
- Studying national and foreign PPP practices and promoting the implementation of the best practices;
- Participating in the creation of umbrella strategies important for the application of PPP;
- Proposing amendments to the acts and regulations relevant to the application of best practices in the preparation and implementation of PPP projects;
- Issuing instructions for implementation; and
- Giving expert opinions on certain issues in the area of PPP.

A set of public-private partnership projects exists in Croatia. Most of them are in the infrastructure sector. The majority of Croatian highways are financed as public-private partnership projects. In the next part of the paper two case studies of public-private partnerships at the local level in Croatia are analyzed.

2. CASE STUDIES

This part of the paper is based on the author's previous research, presented at various conferences.

2.1 The City of Varaždin and Varaždin County

This section concerns two Croatian local self-government units and their experience with public-private partnerships. The city of Varaždin and Varaždin County were the first cases in which a new model for financing the construction of schools and sports facilities was established. They opted for a public-private partnership model.

The city of Varaždin has been a pioneer in implementing local development strategies, applying a mainly bottom-up approach. A city working group developed the economic development strategy of the city of Varaždin for economic development planning at the end of 2001. The strategy identifies a very important question: *“How to ensure and maintain the development of human resources and their connection with economic development?”* It also covers the need for improving the formal education system. Although the strategy does not clearly define the priority area of constructing new schools and enlarging existing ones, it emphasizes the importance of improving the formal system of education, orienting it towards contemporary educational standards that are harmonized with global demands.

An analysis of the city of Varaždin’s budget for the period beginning in 2002, when the city’s economic development strategy was adopted, reveals that several budget years had to pass in order for the development project—which involved the constructing of new schools and the enlarging of existing ones, as well as building school gyms—to be planned with transparency in the budget.

Varaždin County was also among the first counties in Croatia to have adopted a regional operational program for the period between 2006 through 2013, emphasizing eleven development priorities, one of them being *“high-quality education available to all.”* Although the regional operational program does not clearly define the priority area of constructing new schools and enlarging existing ones, several of its measures concern the need to improve the educational system.

Varaždin County was the first in Croatia to enter into a public-private partnership. One major advantage of public-private partnerships is that, under this model of financing, local self-government units spend their current revenues, while capital revenues remain unspent and are saved for other tasks. Private partners finance the construction and maintenance of public buildings owned by Varaždin County; while Varaždin County pays its private partners monthly rental fees a period of 20–30 years.

A public-private partnership was the model of financing used in renovating the County Palace, constructing new schools, and enlarging 42 schools in Varaždin County. The County Palace was the first project in Croatia to be realized as a public-private partnership. The entire project was completed in less than three months (the ground was broken on June 1, 2006 and was finished by September 1, 2006), during which the whole palace (totaling 2,240 m²) was completely renovated. It is important to mention that this palace is a world cultural heritage monument, built in the year 1772. The

cost of renovating the palace amounted to HRK 9 million. Varaždin County will pay monthly fees of HRK 84,000 to its private partner over the next 20 years, while the private partner, Meteor Group, has the obligation of maintaining the palace's interior and exterior.

Apart from the County Palace renovation project, Varaždin County has also undertaken construction projects for two new schools and 15 school gyms, as well as enlarging 27 school buildings, all involving the public-private partnership model (53,000 m²). The total value of these projects amounts to HRK 300 million, with financing from the budget of Varaždin County, the budgets of local self-government units in Varaždin County, and the state budget. The largest amount is financed from private sources via the public-private partnerships model. The construction was planned over two years: the first 20,000 m² in 2006 and the remaining 33,000 m² in 2007.

The basic goal of the project for building new schools and school gyms and enlarging existing school buildings in Varaždin County is to secure the space for various physical development programs for students and to enable single-shift instruction, better school planning and management, and an equal distribution of schools and gyms throughout the entire county area.

The projects for building or enlarging schools and gyms are being carried out by *public partners (investors)*—Varaždin County and its towns and municipalities—and a *private partner*, a specially established company that will function until the BOT contract expires. This company is responsible for designing, executing, and financing the works, as well as acting as a consulting firm that manages the use and maintenance of the schools and gyms.

The project for building or enlarging schools and gyms includes the following phases:

1. Analyzing the current situation;
2. Defining the needs of the school system;
3. Developing project documentation;
4. Training public partners;
5. Calls to interested parties;
6. Binding offers;
7. Analysis and negotiations with investors;
8. Signing a contract;
9. Deadline for adaptation and construction;
10. Maintenance of the facilities (20–30 years); and
11. Transfer of ownership to Varaždin County.

Although the regulations regarding public-private partnerships were adopted only in the second half of 2006 and the beginning of 2007, this did not prevent the highly-motivated officials of the city of Varaždin and Varaždin County from applying the positive elements of this new model for financing development projects (public-private partnership) even earlier, thus encouraging a whole wave of construction projects in the area. The basic advantages of financing development projects using the public-private partnership model are decreased costs and increased loan potential for local self-government units, a division of responsibilities and risks among local self-government and private partners, and greater possibilities for realizing projects without extensive capital investment by local self-government units, thereby allowing them to concentrate on supervising public services, and increasing their level of quality.

One disadvantage of public-private partnership lies in the fact that the desire for greater profits and lower costs may lead to higher prices and a reduced quality of services. It is thus necessary for local self-government to maintain tight supervision over the private partner's activities, to see that they are in accordance with the provisions of the contract between the partners.

2.2 The City of Koprivnica

The city of Koprivnica has been selected due to its specific situation and, above all, because of the fact that it has not prepared any strategic development programs. However, this fact has not decreased the local government's interest in using a public-private partnership to finance the construction of a new school.

Today, the city of Koprivnica defines education and knowledge as an important precondition for local development. However, in mid-2004, when people in Koprivnica began thinking about the need to build a new school, no development strategy had been elaborated and no development priorities had been established, including the construction of any new school building.

It was only in September 2005 that an informational seminar on the development of the new *Local Agenda 21 for the City of Koprivnica* was held. This was a long-term program for sustainable development in Koprivnica, based on a balance between economic activities, protection of the environment, and social conditions, which was completed in 2006. The Local Agenda recognized the problem of the low level of education among the majority of Koprivnica's population (a significant number of people had not even completed primary school). A single-shift arrangement in schools proved to be the best solution, and it was determined that the secondary school population was too large for the existing school facilities.

Although the city of Koprivnica had not adopted a development strategy, the building of a new school began to be discussed in mid-2004, as the existing school facility

accommodated three different schools with 85 classes and 2,850 students in three or four shifts. Koprivnica-Križevac County and the city of Koprivnica were the only local government units in the Republic of Croatia where no secondary school had been built for more than 30 years. The educational structure of the population in both the city and the county was extremely unfavorable.

The city of Koprivnica examined the possibilities for financing construction of a new school. The city's own budget did not have sufficient funds to finance a capital project, and there was no possibility of financing the city's development projects from the state budget. Debt financing by local self-government units, and thus the city of Koprivnica, is severely restricted by the Budget Implementation Act, which limits local self-government units' debt financing to no more than 35 percent of their budget revenue realized in the previous year, decreased by capital income, and only with the prior consent of the Ministry of Finance. In addition, it was not possible to obtain a loan for a period of 25 years.

The city of Koprivnica's only option was to find a new way of financing the construction of a school by using a public-private partnerships model, thereby the city accomplishing its goal of protecting the public interest to the maximum and ensuring the quality of the building as per the contract over a period of 25 years. The total value of this project amounts to HRK 106 million.

The chronology of the construction of the school funded by the public-private partnership model consisted of several phases, and lasted for three years and three months, beginning in June 2004 and ending in September 2007, when the school opened its doors. In June 2004 the city of Koprivnica examined the possibility of financing construction of the school via public-private partnership. Only in December 2004 did the city council adopt a decision to apply the public-private partnership model of financing for the school. In December 2005 a public tender was announced for private partners interested in participating in the project. In January 2006 the suitability of companies that had expressed an interest in participating in the project was evaluated. In February 2006 a tender for binding offers was announced, and in May 2006 the bids were opened. From May to July negotiations were held with all the bidders, and only on July 10, 2006 was a public-private partnership contract signed. Construction work began on July 24, 2006, and the school opened its doors in the beginning of the school year, September 3, 2007.

The private partner entered into a contract with the city of Koprivnica concerning construction of the school with a 25-year right of use. The construction risks and availability were assumed by the investor, while the demand risk concerning occupancy of a sports hall for commercial purposes was divided, such that the contractor assumed 90 percent and the investor 10 percent of demand risk. The compensation payment for the use of the school will be paid by the city of Koprivnica in 286 monthly installments of HRK 700,000. This means that a significant part of the city of Koprivnica's capital budget is free to use for financing other important development and infrastructure projects.

In addition, the public-private partnership model has provided a number of other advantages:

- the public partner paid for all the services delivered, for example, construction of the school canteen;
- the same quality of service has been ensured for a period of 25 years, and the standard of the school's maintenance was defined as the private partner's obligation;
- construction of the school was financed without any significant budget burden, and without a deficit; and
- public interest was protected to the maximum.

The supervision and inspection of the construction is organized at the city level. This is contractual duty of a special firm for construction supervision. Maintenance is the duty of the private partner for period of 25 years.

Today, with its new school, the city of Koprivnica may proudly state that knowledge and competence have been the major driving forces behind development in the city of Koprivnica, which is regarded as the place in Croatia with the most favorable conditions for education and the highest-quality educational services.

3. RISK ALLOCATION

Fiscal risk can be defined as the exposure of the government's or local government's budget to the performance of underlying public investments either procured or managed in a traditional way or as a public-private partnership. In these two selected projects, local governments' fiscal risk exposure depends on the division of tasks and risks with regard to the design, construction, operation, maintenance, and financing of the project. Public-private partnership is the joint realization of a public interest project by a public entity and a private partner (consortium). Public and private parties divide and/or share tasks and responsibilities and the corresponding risks. The division of tasks, responsibilities, and risks is formalized through a public-private partnership contract, with private sector capital being at risk in the delivery of public services.

In selected Croatian cases public-private partnerships take the form of long-term contracts designed to transfer construction and maintenance risks from the public sector (cities and county) to the private sector (partner). Availability and operational risks as well as, partly, demand risk are transferred from the public (the city of Varaždin and Varaždin County, as well as the city of Koprivnica and Koprivnica-Križevci County) to the private sector, too. Public partners (the town of Koprivnica and Koprivnica-Križevci County) are responsible for one small part of the demand risk.

Since risks are allocated to the party best able to manage them, public-private partnership contracts are able to effectively reduce risks (chance of occurrence and/or consequence) and local governments' risk exposure, thereby creating value for money and reduced fiscal risk.

4. CONCLUSIONS AND RECOMMENDATIONS

There are several important conclusions to be drawn from these two Croatian case studies.

Strategic development document

The preparation of a strategic development document at the local and regional levels is essential for identifying strategic priorities, and also provides a tool for applying for and receiving EU funds.

Coordination of strategic development document with local budget

Another positive conclusion is to recognize the importance of the parallel adoption of a strategic program and a budget.

Non-budget revenue sources to finance capital projects

Local and regional self-government units in Croatia share the problem of inadequate financing. The practice of the selected Croatian cities shows that local budgets are not the only source of revenue for financing urban development projects. The solution for local and regional governments is to find additional revenue sources for various development projects.

A lack of public funds is the predominant reason for *private sector involvement* in financing local and regional investment projects. Apart from this, there are several other reasons for private sector involvement in the financing of urban projects: increased local and regional needs, the inadequate structure of local and regional revenues, the size of local and regional development projects, and limitations on debt financing at the local and regional levels.

Future challenges in financing capital projects

Partnerships between central, regional, and local governments, nongovernmental organizations, the private sector, and all the other major actors involved in regional and local development will create useful forms of effective interaction, such as participation by representatives of various institutions in activities, initiatives, and procedural rules for consultation on budget drafting, or planning major capital projects in local areas. The existence of an active network of different actors indicates an awareness of the need for

joint action and inter-institutional cooperation when seeking revenues for local and regional development.

In order to play a major role in the coordination and promotion of regional and local development, regional and local governments must face the main challenges with regard to the demands and conditions of local economic development. This includes searching for a reasonable balance between the public and private sectors at the local level and the use of private sector methods and approaches in local public management. Public procurement and other forms of contracting are the tools of modern local government.

Increasing tendencies towards liberalization, the shortage of funds in practically all budgets, and the process of internationalization have all created new market conditions in the infrastructure sectors of transport, energy, the environment, and community services, as well as in the building of schools and sports facilities. This means that public-private partnership is the keyword for development at the state, local, and regional levels alike. The state's supervisory function is coupled with the operational efficiency of the private economy. Practice has shown that public-private partnerships represent a viable and frequent project financing alternative in cases where a project is of sufficient size and possesses a high degree of self-financing induced by cash flow, as well as in cases where efficiency improvements can be successfully realized.

The government of the Republic of Croatia has begun the process of decentralization, defining it as the leader for its future activity in many areas. The government has continually expressed its unequivocal political support for decentralization. This means that local development will depend on initiatives at the local level, including new ways of financing capital projects.

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Risk Assessment of Public-private Partnerships Implemented in Hungary

*Risks, Management Efficiency,
and Fiscal Relations*

Karoly (Charles) Jokay

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EXECUTIVE SUMMARY

This study initially takes a broad approach to methods of involving private service providers and capital in delivering public infrastructure. Before EU accession in 2004, there was practically no legal framework in Hungary that specifically defined what a PPP is. PPP, from the national government's perspective, is viewed as an important tool for avoiding various restrictions on the total stock of public debt (60 percent of GDP) and fiscal deficits (no more than three percent of GDP).

Policy recommendations based upon Hungary's experience at the central level, and its limited, narrowly defined PPP experience at the municipal level, will be aimed at complying with the Eurostat definition of off-balance sheet, long-term service contracts with private financing where the private sector assumes significant risk. Eurostat compliance means that the legal and financial framework of the project is analyzed from the perspective of which party—the public sector or the private sector—bears most of the risk.

PPPs do not exist as a separate legal category in Hungary. In other words, PPP transactions involve legal entities that are defined elsewhere, using aspects of competition, procurement and concession law where appropriate. Secondary regulations, such as the definition of debt, have been inconsistently modified to acknowledge the presence of PPP arrangements. The Hungarian Treasury treats PPP obligations as a form of commitment that is limited by the annual budget (but not counted as national debt). On the other hand, the municipal law does not mention PPP specifically, and any long-term payment obligations of a municipality to a PPP operator (such as availability fees) are not recorded as municipal debt. In fact, long-term service contracts, if they are not a part of a concession agreement, also do not appear as long-term obligations, and do not hinder the municipality's future borrowing capacity (even though free cash flow is certainly influenced).

The case study of Veszprém's sports arena demonstrates that a PPP framework was chosen with creative features all aimed at avoiding "debt" while still legally assuming a long-term obligation to pay availability fees. The most evident risk, known as a "classification risk," faced by PPP project sponsors in Hungary, regardless of whether they are central ministries or municipalities, is that their project is classified according to Eurostat standards as being state debt, or in the case of municipalities, the project's financing scheme burdens its debt service capacity needlessly. Since PPP payments are not yet regulated by national law at the municipal level, their inclusion in debt limits or in a separate category of obligation as exists at the state level, already means municipalities face significant policy risk if they engage in projects that meet PPP standards.

“PPPs are a necessary evil. We would have never come up with schemes like these ourselves without outside inspiration. And the banks have always been able to outthink these ideas in short order.”¹

1. NATIONAL AND LOCAL REGULATORY/LEGISLATIVE NORMS GUIDING PPPS

1.1 Introduction

This study initially takes a broad approach to methods of involving private service providers and capital in delivering public infrastructure, since before Hungary’s EU accession in 2004, there was practically no legal framework in Hungary that specifically defined what a PPP is. Even the EU’s statistical office, Eurostat, only issued guidelines on what it considers an off-balance sheet PPP in 2004, several years after Hungary attempted to develop procedures for approving state-level PPP project proposals. Therefore, many projects that were heralded as examples of PPP in the 1990s and early 2000s have to be “relabelled” as quasi-disguised public debt or simple purchases of long-term services under a variety of financing schemes.

Policy recommendations, however, based upon Hungary’s experience at the central level and limited, narrowly-defined PPP experience at the municipal level, will be aimed at complying with the Eurostat definition of off-balance sheet, long-term service contracts with private financing where the private sector assumes significant risk. Eurostat compliance means that the legal and financial framework of the project is analyzed from the perspective of which party, the public sector or the private sector, bears most of the risk. These risks include market risk, availability risk and performance risk. The private sector must bear performance risk and one other, or else the entire scheme is considered to be “public borrowing” and does not qualify as a “genuine” PPP structure. So while there are few “Eurostat compliant” examples of PPPs in Hungary, especially at the subnational (i.e., municipal) level, the wealth of experience going back to the first concessions in the early 1990s do indeed offer suggestions for municipal level prudence in evaluating options for public versus private financing of investments through service contracts.

The specific definition of what Eurostat considers to be a “genuine” PPP project that does not “hinder” either the annual deficit nor total state debt is as follows:

*The investment being made is considered to be off-budget and off-balance sheet, if the following two conditions are met. First of all, the private investor has to assume all of the construction risk. Secondly, the private party has to assume **one** of the following risks, availability risk or demand risk.*

If these conditions are not met, then Eurostat considers the project to be on the balance sheet and budget of the public entity. This definition may be too restrictive for Hungary now, but in the long run, this type of Eurostat compatibility could become a final point on an evaluation checklist. A project that does not meet this definition still needs clearly identified and allocated risks, and very thorough analysis. In no way should one assume that projects that do not meet the above conditions are “not PPP” projects in every other sense. They could be, but any regulatory framework, PPP legislation, approval process, or evaluation system should take Eurostat into account.

There are various models of PPP under design and implementation at both the state and municipal levels of government in Hungary. Financial institutions, construction companies, and private investors approach national and local governments by offering various schemes for financing government projects, using the full realm of financial engineering such as BOTS, DBOT, and such. On the national government’s side, there was limited knowledge and information on PPP schemes until the creation of an Interministerial PPP Committee in 2003 to regulate PPPs in those cases where the state itself assumes a long running commitment. The contracting rules are not widely known, and the audit methods of PPP projects are underdeveloped, though they rely heavily on methods used in the United Kingdom, such as the public cost comparator or value-for-money analysis.

PPP, from the national government’s perspective, is viewed as an important tool for avoiding various restrictions on the total stock of public debt (60 percent of GDP) and fiscal deficits (no more than three percent of GDP). Many Hungarian State Audit Office (SAO) reports have determined that projects that use 20–30 year financing through PPPs end up costing more in net present value terms than if the same investment were made using sovereign borrowing. The additional cost, it seems, is justified by the fact that an over-indebted country like Hungary can use PPPs to avoid increasing the budget deficit or state debt. In fact, “Maastricht optimization” is a frequent subject of international conferences on PPP. PPP projects consequently are implemented for reasons other than “best value for money” in some cases, and this adds additional levels of risk (Báger 2007, 62).

Nonetheless, the Interministerial Committee on PPPs set up by the national government in 2003, as well as evaluations of national level PPP projects such as motorways, university housing, and cultural facilities, do offer many significant lessons learned for developing regulations, best practices, or at least recommended practices for Hungary, Serbia, and other southwestern Balkan countries. Evaluations and lessons learned from national PPP regulation in Hungary will thus be “projected” onto the local level to the fullest extent possible.

1.2 Background

PPPs do not exist as a separate legal category in Hungary. In other words, PPP transactions involve legal entities that are defined elsewhere, using aspects of competition, procurement, and concession law where appropriate. Secondary regulations, such as the definition of debt, have been inconsistently modified to acknowledge the presence of PPP arrangements. The Hungarian Treasury treats PPP obligations as a form of commitment that is limited by the annual budget law (but not counted as national debt). On the other hand, the municipal law does not mention PPPs specifically, and long-term payment obligations of a municipality to a PPP operator (such as availability fees) are not recorded as municipal debt. In fact, long-term service contracts, if they are not a part of a concession agreement, also do not appear as long-term obligations, and do not hinder the municipality's future borrowing capacity (even though free cash flow is certainly influenced).

Concessions for water, wastewater, and solid waste services, and the assets that are created to provide these services and funds that move between the concession holder and the municipality are accounted for separately. In some limited cases, rental fees paid to a concession firm are deducted from cash available for other debt service. Concession fees, paid by an operator for "use" of municipal fixed assets are also accounted for separately. These bookkeeping rules are important factors in the evaluation of PPP projects, i.e., whether they count as concessions, borrowing, or simply long-term service contracts. This kind of determination on the local level directly affects borrowing capacity for other purposes. The most widespread involvement of enterprises organized on a commercial basis (though perhaps 100-percent municipally-owned) in service delivery is based upon long-term service contracts under commercial law or concessions under concession law and the applicable sectoral laws.

PPPs *per se* are a latecomer in this game, as over 300 water and wastewater companies serve nearly 3,200 municipal jurisdictions, and most of these firms are partially or entirely municipally-owned. Even the seven regional water companies that remain state-owned are organized as joint stock companies. New services are added, in most cases, under publicly-procured concession schemes. PPPs that meet the narrow definition used by Eurostat have been, to date, inspired by national government programs made available at the local level, such as dormitories, swimming pools, gymnasia, or multifunctional arenas.

Although the main thrust of this study should be lessons learned in the regulation of PPPs and risk management at the local or municipal level in Hungary, it is important to point out that the government decree on PPPs and the activities of the Interministerial Committee do not address PPPs at the municipal level. In fact, unlike the state level, the local level in Hungary does not list payment commitments in a PPP project as a part of municipal debt, and hence such payments do not count against the debt limits of local

governments. In contrast, the net present value of total payments by the central state for PPP projects may not at any time exceed three percent of the annual state budget.

The state level uses PPP deals, instead of borrowing, to build major infrastructure items such as motorways, concert halls, college dormitories, prisons, and cultural facilities, in order to avoid increasing the current budget deficit or adding to national debt. Regulation at the EU level had to catch up to the market, with Eurostat issuing instructions² on evaluating and recording PPP deals only in 2004, a year after the Interministerial Committee issued their own *PPP Handbook*.

In this fluid regulatory environment, with the perverse incentive to avoid exceeding the Maastricht budget deficit and debt restrictions, Hungarian municipalities have rejected standard BOT and other PPP models in many cases, reverting to their own resources and bank financing, since their PPP commitments do not count as debt, and the larger municipalities have not used up all of their borrowing capacity.

1.3 Description of Legal Framework

Although there is no single law on PPPs in Hungary, and the Concessions and Procurement Laws, respectively, do not mention PPPs at all, there are three perspectives from which PPPs are regulated:

- First, the *procedural steps* to be taken by project sponsors, such as ministries and central government agencies, are defined in a series of government decrees and decisions, but not by law.
- Second, these same decrees and decisions require the compliance of proposed central government: PPP projects with *national development priorities* that are proposed by the National Development Agency, then approved by the cabinet twice a year.
- Third, since the PPP projects that are regulated through these decrees and decisions are all supported by the central budget (not by municipal budgets), the annual Budget Act, as well as the Budget System Law, regulate the *procedure to be followed* when the state assumes a *new liability*. Not all long-term liabilities, such as service contracts and PPP fees, are counted as “debt” under Hungary’s municipal regulations. If those long-term obligations meet Eurostat standards as “genuine” PPP projects, then no measure of debt service includes them. This leads to distorting behavior, and data on long-term obligations and creditworthiness are also distorted by these attempts to avoid commitments explicitly identified as debt.

These new liabilities, including current PPP liabilities expressed in present value terms, may be no more than three percent of the gross national budget. Thus, PPP projects proposed by central government “budget subjects” are screened from three perspectives: procedural and formal, compliance with national development goals, and impact on overall PPP liabilities. These national PPP projects are regulated only if the state assumes a partial liability, or wishes to classify a future stream of payments as an “off-budget” liability under Maastricht.

This model outlined above does not apply to municipal PPP projects, unless there is a state budget transfer or subsidy involved, as there was in the case of the largely unsuccessful Sports 21 municipal swimming pool and sports center project. However, what was essentially a “three-pronged” compliance checklist could be used in modified form at the municipal level, since according to the SAO one of the most significant problems in comparing PPP projects to traditional financing options was selection of the proper discount rate and inappropriate, or even biased the financial modeling, and risk allocation that was clearly to the advantage of the proposed private partner.

Unfortunately for Hungarian municipalities, PPP obligations do not have to be listed as debt and are therefore not counted against debt limits. But, given that there is no separate obligation restriction as there is at the central level, Hungarian municipalities find that traditional bank or bond financing is much more economical than PPP availability payments, hence they tend to shun PPPs since the public cost is apparently much less, and few municipalities have reached their borrowing limits.

The Ministry of Economics and Transport (reorganized as the Ministry of Economic Development) was charged one year before EU accession (2004) with the responsibility of carrying out Government Decision 2098/2003 to create an interministerial committee on PPPs. The Economics Ministry handed off responsibility for the committee to a newly combined Ministry of Transport and Communications in June 2008, but for the purposes of this paper, almost all documents related to PPP were published by the Economics Ministry as late as January 2008.³

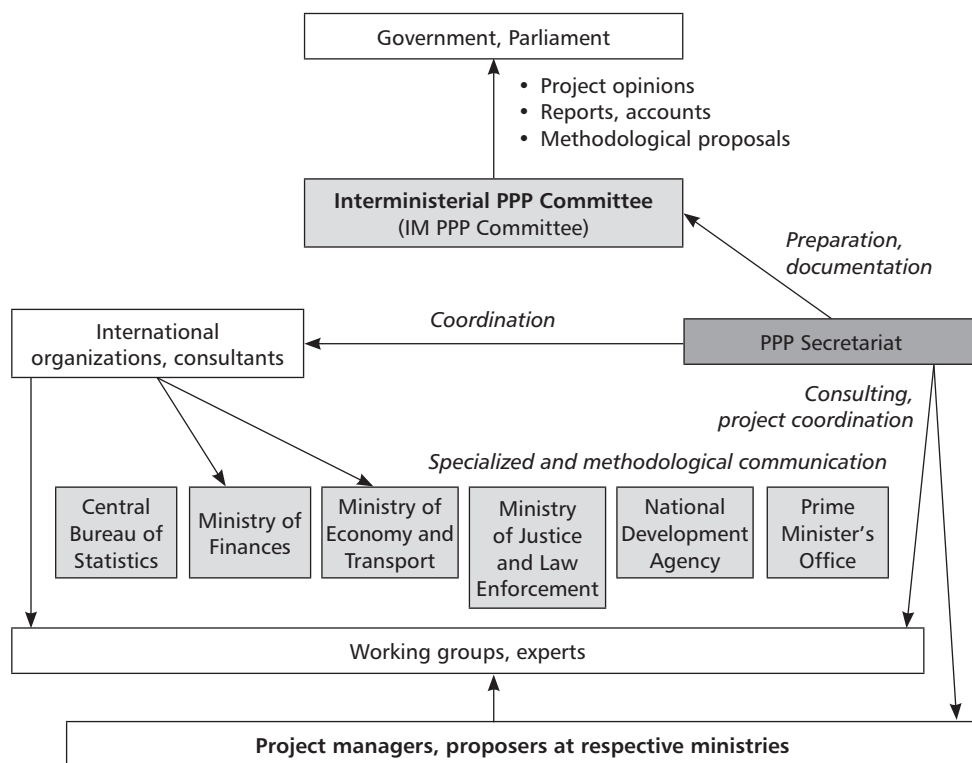
It became apparent that in the run up to EU accession, large infrastructure projects organized on an *ad-hoc* basis as PPPs (M1, M5 motorways) could have an effect on Hungary’s public deficit and debt statistics. As Eurostat did not issue an opinion until 2004 (to be discussed later) that defined what kind of PPP project is considered to be public debt and what is not, under ESA 95 (European System of Accounts), the ministry had to develop its own procedures in advance of Eurostat’s guidance.

PPPs, in the opinion of the SAO (as expressed in numerous evaluations of motorway and cultural facility projects), and the Economics Ministry’s *PPP Handbook* (MoE 2008), started in Hungary in the mid-1990s at the initiative of the private sector. As EU accession approached, it became apparent that PPPs would be critical in financing public infrastructure “off the balance sheet.” So the regulatory framework expressed in Hungarian government decisions and decrees have to address the classification system

of projects, i.e., whether they add to public debt according to Eurostat. *Thus, the main justification for PPP projects at the state level is not necessarily increased efficiency nor lower overall cost, but rather reduced fiscal pressure, perhaps quicker implementation, and easier compliance with the Maastricht criteria* (PPP Handbook 2004, 16).

Figure 3.1

Actors in the Central State PPP Project Approval Process in Hungary

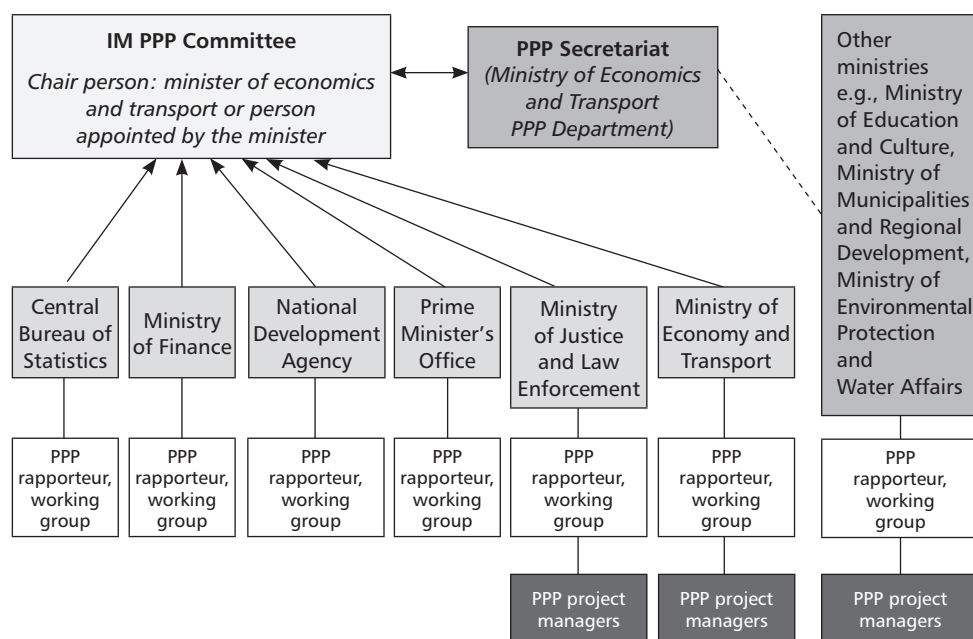


Source: MoE 2008.

1.4 The Interministerial PPP Committee (2003–2009)⁴

The Interministerial PPP Committee held its first meeting in June 2003. Its members consist of the Ministry of Economics and Transport, Ministry of Finance, Ministry of Justice, the Prime Minister's Office, and the Statistics Office.

Figure 3.2
Structure of the Interministerial Committee



Source: European Commission (2003–2006, 4).

As of 2007, a representative of the National Development Agency was added. The committee published a very useful “Guidance Document” (MoE 2008) on PPPs in January 2008 that describes in detail the approval process for those PPP projects that are sponsored by central government ministries and agencies, and that meet Eurostat definitions and are in line with national development priorities set by the government. *But the guidelines do not apply to municipal projects, unless there is a commitment of central budget funds*, hence requiring the approval of the Finance Ministry, Cabinet, or even Parliament, depending on its scale. As municipal projects are neither approved nor guaranteed by the central government, the guidelines are only a useful potential example to follow.⁵

The Interministerial Committee, chaired at the state secretary level, has the following responsibilities, among others:

- Provide expert opinions on PPP plans before the economic cabinet, central government, or parliament considers them;
- Methodological guidelines and information with the public administration sector;

- Monitoring PPP projects as they are implemented;
- Assessment of the post-implementation phase;
- Commenting upon needed changes in other legislation, such as public procurement, concessions, competition, etc.
- Issuing an annual report on the status of centrally-sponsored PPP projects;
- Developing and improving the procedural rules for implementing PPP projects;

As PPP liabilities assumed by the central state in Hungary are subject to approval by the Cabinet, the scope of such liabilities is regulated by the Public Finance Law (Act XXXVIII, 1992, Article 126/B), and the annual commitment must appear in the state budget. This means that PPP proposals must entail a detailed justification, an evaluation of liabilities in net present value (NPV), a detailed financing and investment plan, monitoring, etc., as well as calculation of the public sector comparator. The cabinet must, in all cases, approve these liabilities that may not exceed three percent of the aggregate amount of the state budget. This means that existing liabilities, as well as new commitments must be calculated each year. The government also provides a biannual list of priorities that reflect development policy. The Interministerial Committee thus takes commitment limits as well national priorities into account when issuing opinions on projects. These projects must include cost-benefit analysis, comparisons with alternative sources of funding, cash flow plans, consideration of risks, cancellation policy, ownership issues, etc. The Committee has 45 days in which to evaluate proposals that are in compliance with national priorities. An important aspect is that Government Decree 161/2005 defines the methodology to be used for calculating the net present value of obligations and benefits. The ministry publishes the applicable discount rates on its website.

The guidebook also offers a very useful outline for the project plan. This outline could be used at the municipal level, and is in most senses fully “exportable” to other regulatory systems. The full structure of the project plan used in the process above appears in the guidebook. Because of the sheer volume and level of sophistication involved in this procedure, it is apparent that most municipalities would find it difficult to comply without significant external expertise.

Lessons Learned by the Interministerial Committee

The Committee is legally obligated to issue annual reports on its activities.⁸ In the period between 2000–2006, the only regulation in force regarding PPPs was Government Decree 217/1998 on procedures for assuming liabilities on behalf of the state. The best and worst practices were thus left up to the individual program sponsors, that is, the line ministries. There were several problems in the way in which the Committee

worked to evaluate PPP proposals presented by various ministries. These included a lack of prescreening to determine whether the project was suitable for PPP, and whether there were funds available. The content and quality of the proposals varied widely. The Committee, despite a legal obligation on the part of project sponsors, was not contacted regularly during the procurement phase. There was no unified list of projects under way or proposed, nor was there a single list of state funds already committed to these projects. The Committee was not informed during the implementation stage, nor was there a single set of transparent operating procedures among the sponsors. Sponsors were not required to seek the preliminary opinion of the Committee before a project idea was presented to the Cabinet. Sometimes the Ministry of Finance received proposals that were not submitted to the Committee. These problems led to a new Government Decree, 24/2007, that regulates long-term obligations assumed in PPP schemes and corrected the coordination problems cited above.

The Committee's suggestions for improved procedures could be applicable in other countries considering a PPP framework for both the state and municipal levels. For example, the minimum scale for consideration by the Committee was suggested to be at least HUF one billion or EUR four million. Similar small projects should be packaged using standardized forms and evaluated together. This means that a pilot project is to be carried out first, then the standardized documentation applied universally. The problem of small projects in large numbers in the municipal sector still needs to be addressed by this regulatory scheme.

1.5 Public Procurement and Concessions

Depending on the type of project involved, implementation will be subject to the Public Procurement Law (Act XXIX 2003) or the Concession Law (Act XVI 1991). There is no specific mention of PPPs in either act, thus the type of procedure chosen depends on the content and value of the projects. However, this could be considered to be a missing aspect of policy; the procurement act already has over 400 articles, hence adding more may not be efficient. The Public Procurement Act covers works and service concessions, under which most PPP projects may fall. If the works concession also falls under the Concession Act (water, wastewater, transport, etc.) then the appropriate section of the Procurement Act is used. The Public Procurement Act distinguishes between three types of procedures: (1) procedures applicable for projects with a value of at least equivalent to or exceeding the community thresholds, (2) procedures applicable for projects with a value equivalent to or exceeding the so-called national thresholds, (3) procedures applicable for projects with a value equivalent to or exceeding the so-called simple thresholds.

The following extract from the guidance document summarizes the relationship of PPP projects to both the concessions and procurement laws in Hungary:

The Community and the national rules of procedure are to a large extent similar; the regulation of the simple procedure is more flexible due to the low value of purchases. In accordance with the Community's public procurement directives the Public Procurement Act governs the purchases of two groups of awarding authorities, (1) the so-called classic awarding authorities—i.e., public participants and local governments in a broad context and organizations which do not belong to this scope of participants and had received aid either from the state or the EU—and (2) so-called utilities—i.e., organizations operating in the water, energy, transport or postal sectors. Rules of procedures governing utilities are more flexible (MoE 2008: 20–23).

National PPP projects are generally implemented under procedures applicable to projects with a value equivalent to or exceeding the community threshold and initiated by classic awarding authorities. Different types of public procurement procedures exist. To put that simply, there are procedures where the awarding authority decides on awarding the contract (namely for PPPs it selects the private partner) based on the tenders received, without negotiations. As opposed to this, there are procedures that allow the awarding authority to negotiate the contract conditions. In this latter case, the contract shall be concluded with the tenderer whose tender proves to be the most favorably evaluated against predefined criteria upon closing negotiations. Negotiated procedures may be initiated with or without the publication of a contract notice. These procedures can be applied solely in case the conditions specified in accordance with the community's public procurement directives in the Public Procurement Act:

Concession tenders are public; excluding restricted tenders when national defense or national security interests prevail. Public notices shall be published in at least two national daily papers; notices by local governments shall be published also in the local daily paper. Rules relative to guarantees had been specified also in the Concession Act (e.g., the minimum period before the deadline for submission of tenders), still we can conclude that the rules relative to concession tenders are more flexible than those on public procurement. The reason for this is the fact that community legislation has not yet been adopted in this field, except for works concessions.

EU directives on procurement have not kept up with the development of PPPs, and certainly some legislative harmonization at the community level is still needed before this legislation can be optimized in Hungary.

The Unique Situation of Municipalities

PPPs are not specifically regulated at the local government level in Hungary. In other words, the policy instruments described earlier, such as review and coordination procedures, compliance with national development goals, and restrictions on non-debt liabilities, only apply to projects proposed by the central government. The SAO (Báger 2007, 78) has pointed out that even the State Audit Office does not have an inventory of municipal-level PPP projects, unless the municipality was involved in an audit, or there were state funds provided in a local PPP scheme (as is the case with Sports 21). What was apparent from previous investigations by the SAO is that at the municipal level most projects are poorly prepared, there is no examination of efficiencies, and that municipalities faced a capital budget deficit, and wished to avoid burdening their borrowing limit when they attempted a PPP approach to obtaining a service.

To fully understand the regulatory context for PPPs in Hungary, it is important to point out that:

- Hungarian municipalities received most former council and some types of state property within their jurisdiction in the early 1990s.
- Hungarian municipalities have full property rights, except over “core property” used to deliver vital services (streets, water works, pipelines) and other obvious public spaces (parks, squares, statues, etc.)
- All council-owned and state-owned enterprises, such as waterworks, had to be “transformed” in the early 1990s into limited or joint stock companies—i.e., despite municipal ownership, these limited companies are not “public enterprises or JKP” as in the former Yugoslavia. These could, but were not all necessarily, sold to private owners.
- Hungarian municipalities have to “ensure the provision of” a list of vital services⁹ such as public health, sanitation, street lighting, cemeteries, etc., but “how” these services are delivered is up to them as long as they comply with other sectoral laws. This means that contracting out, concessions, and the use of private firms perhaps not even in municipal ownership, has been standard practice since 1991. (PPPs have to operate in a crowded environment.)
- The above means that Hungarian municipalities have 18 years of experience in “managing” rather than delivering vital services.
- Municipalities have price-setting authority for water, wastewater, solid waste, chimney inspection, and similar communal services. Where a regional, state-owned water company provides the raw water, there is a state-set wholesale price that the municipalities may mark up. In some areas, the state-owned regional water company sets rates directly if it is involved in retail distribution.

- Incentives to provide public services outside of the budgetary and administrative framework are mostly related to VAT reimbursement; amortization is realized through rental or leasing payments to the municipality to give an impression of greater efficiency, faster and more flexible decision-making, and the opportunity to move expenses off-budget and keep revenues away from the budget.
- Given restrictions on the non-public ownership of core assets constructed with public funds, such as sewers or landfills, private capital is involved in operations, marketing, etc., while heavy infrastructure investment in municipal services hardware uses public funds (i.e., private capital is attracted in concession agreements, where the assets remain in public ownership, but the financing is private. PPPs have a similar logic at the state level).
- The restriction on core property being mixed with private capital has been administratively loosened since January 2007, when municipalities may sign asset management contracts with private firms and this includes the right to amortize the asset being granted to the private firm. *De jure* ownership remains with the municipality.

Mistakenly in Hungary and perhaps elsewhere in CEE, a full range of options, ranging from contracting out, joint ventures, leasing of assets, service contracts, and concessions, are identified as being forms of PPP outside of the Eurostat definition. Formal evaluation and policy on PPPs in Hungary exists at the state level since 2003, as PPPs engaged by municipal governments do not enjoy the guarantee of the state budget, unless specifically approved by Parliament. Municipal borrowing and other long-term commitments do not need ministry approval or review, and most municipalities operate significantly below their borrowing limits. PPPs at the local level in Hungary are in a sense not properly recorded as debt or long-term commitments, and instead show up in different forms, such as long-term service contracts or concessions.

In fact, some municipalities,⁶ such as the county capital Veszprém, actually rejected using a PPP scheme in 2006 to build a multifunction sports and convention facility, saving about 30 percent on construction costs by using its own borrowing capacity. County capitals such as Veszprém are far from exceeding their borrowing limits, unlike the national government, and do not need to resort to PPP schemes to reduce their debt stock or reduce a budget deficit.⁷ This debt does not enjoy any sovereign or national budget guarantee, however, and does show up in the national debt figures. But overall municipal debt is less than five percent of overall public debt stock, so municipalities do not need to disguise their borrowing in the form of long-run service contracts under PPPs. Of course, the definition of debt in other forms such as long-term service contracts, guarantees, etc., is still needed, but is not expected to greatly influence the total amount of public debt in Hungary.

The government proposed the Sports 21 program to build up to 169 swimming pools, gymnasia, and other sports facilities in municipalities that were in underserved areas. The Ministry of Local Government, which holds the sports portfolio, prepared an application package with standardized proposals, plans, financial analyses, etc. The program would involve a 30–50 percent budget subsidy to the availability fee to be paid by the municipality. The private partner would have assumed construction and availability risk. Only about 17–30 projects will be contracted and completed (more details to follow in the case study section) solely because municipalities could not afford the availability fee for 15 years, even with the subsidy. Many went ahead and built their own facility using traditional financing, and others backed away from the program. Another significant problem was that the construction bids came in sometimes at a multiple of the original estimate. Banks were also reluctant, as the agreement packages were small and complicated, and perhaps the “value-for-money” principle really was applied correctly by all players (Bager 80).

The SAO sees several areas in which municipalities may increase their PPP activity in the future if the legal framework were clarified. These all involve mandatory municipal functions such as: rental housing for social welfare, water and sewer, solid waste, local roads, local public transportation, daycare and kindergartens, sports facilities, health facilities, and homes for the elderly. The Concession Law, Local Government Law, and various sectoral laws sometimes hinder the use of PPPs in the municipalities. Up until 2007, the Local Government law did not allow municipal core property to be partially transferred for use only to the private sector. On January 1, 2007, a new property management clause was added to the Law on Local Government, essentially allowing municipalities to place some of their core assets into a trust, i.e., a private firm would have the right to amortize the property—to enjoy its fruits but at the same time be obligated to maintain and protect the property. This property management rights transfer to the private sector made this form of “alternative” PPP possible. A great deal of responsibility rests with the municipality, in that a local ordinance is needed to govern this arrangement. Typical of Hungary, the central government made this type of “trust” relationship possible without providing guidelines or examples to all the municipalities on suggested methodologies and actual legal texts.

The SAO (Báger 2007, 82–83) concluded that two other important challenges need to be addressed at the municipal level. Namely, projects that are not sponsored in part by the central state (as in the case of Sports 21) have ambiguous bookkeeping and accounting methods, and the Treasury is uncertain as to whether municipal PPPs increase state debt overall, or meet the same standards as PPPs that have been screened by the Interministerial Committee. A second obstacle, mentioned the introduction, is that the language on debt limits referring to municipalities needs to be modified to include other obligations, such as availability fees in a PPP project, for example. Though it has not happened yet, the SAO hopes that such a change will prevent municipalities from using PPPs to dodge the borrowing limit by taking advantage of this loophole.

2. LEVEL OF INSTITUTIONALIZATION OF PPPS —TYPES OF PPP STRUCTURES

Hungary has had experiences with outsourcing, service contracts, concessions, and the like since the early 1990s. These arrangements, including offering the private sector the right to operate public assets such as wastewater plants, are not considered by the Economics Ministry's *Handbook* as being versions of PPPs for the simple reason that the funding of the investment comes from public funds, and the asset in most cases is accounted for as a non-negotiable or "core" public asset. The handbook (MoE 2004, 20–22) describes outsourcing in three forms: service contracts up to five years in duration, operational contracts in the medium term, and leasing.

Under operational contracts, the contractor may be obligated to make improvements. In leasing arrangements, the private firm leases a new or existing public asset, such as a water system, and is responsible for refurbishment and renewal. These contracts usually generate their own revenue, and have terms of five to 15 years. These are the most typical "concession" contracts in Hungary, which offer only the right to operate but not ownership of an asset. The concession form is used by municipalities to operate water and wastewater facilities that are a non-negotiable property of the municipality. In the 1990s, genuine concessions could not be offered in Hungary because public and private funds could not be combined for the building of new facilities that, by law, must be the core property of municipalities. In this sense, operational concessions in Hungary cannot really be classified as PPP projects, though the two sectors are cooperating.

The Economics Ministry's *Handbooks* (from 2004 and 2008) regard those arrangements as PPP which integrate all phases of the project: planning, financing, operation, construction. BOTs are still financed by the state in the water and transportation sectors. DBFOs (design-build-finance-operate) still require that the assets remain in state ownership over the duration of the contract, and the operator provides leasing payments to the owner (as in concessions).

A difficulty in defining and regulating PPPs in Hungary stems from restrictions on transferring core municipal property (assets used to deliver mandatory services) to the private sector. Starting in January 2007, municipalities were allowed to transfer asset management rights over public property to private operators in "trust" arrangements. This means that, as in other countries, assets built with public funds could appear in the books of private operators while ultimate ownership remained in the public sector. This became possible at the municipal level only in 2007. Hence, there is still a dearth of "genuine" PPP projects among municipalities.

The SAO, Hungarian Statistical Office, and the Interministerial Committee are obligated to use the ESA 95 definition of PPPs in their ranking and evaluation of PPP proposals at the national level. A project is only considered as being a PPP (and off the

national balance sheet) if it is a contract for long-term services, and not a disguised loan. The Statistical Office must use Eurostat's 2004 guidelines and examine the complicated details of each proposed contract to determine whether the project meets PPP criteria. A project can only be labeled as being a PPP if it meets Eurostat's requirements concerning risk allocation. These requirements are even today not always clearly met, and hence most of what look like PPP projects in Hungary cannot be really considered as being examples of PPP for these reasons.

However, Eurostat's guidelines were only published in 2004, so Hungary is not the only country with "false" PPP projects that could be reclassified as being disguised public debt. In order to be labeled as a PPP project, the private contract must assume all construction risk. Furthermore, the private firm must assume one of the following risks: availability risk or demand risk. Thus Hungary's early motorway concessions in the late 1990s that were later cancelled at great expense could not be considered as "genuine" PPPs since the state paid the concessionaire an availability fee, as well as a shadow toll guaranteeing a certain level of traffic regardless of actual usage. Water concessions at the municipal level also did not pass on either availability or demand risk, and therefore do not meet the Eurostat conditions for being considered a PPP project.

2.1 Some Examples of PPPs in Hungary

Until 2003, PPPs came about at the national level in areas such as motorways and cultural facilities. These early attempts were expensive for the state, contained too many guarantees for the private investor, and were used mostly to avoid increasing current deficits and for moving state debts off the national balance sheet. Despite a government decision in 2003 creating the Interministerial Committee on PPP, and the subsequent publication of guidelines and several editions of a PPP manual in 2004 and most recently in early 2008, PPPs are still largely unregulated and unstandardized. The State Audit Office, in a report on PPPs issued in April 2003, asserted that its own audits of PPP projects, as well as the experiences of the Interministerial Committee, show that there still is a need in Hungary for rules on how to evaluate PPP proposals and how to conduct long-term forecasts and estimates of net present value. The Interministerial Committee and the SAO argued for changes in the Concessions Law and the Public Procurement Law to take PPPs into account.

Table 3.1 from the PPP Committee's 2007 report shows the status of "recognized" PPP projects in Hungary as of January 2008.

Table 3.1

The Status of “Recognized” PPP projects in Hungary as of January 2008 (MoT 2007, 6)

Description of the PPP project	Indexed (estimated) fees (annual) HUF million gross			Project NPV (Net Present Value) (without VAT) HUF billion	Project manager
	2006	2007	2008		
Central Universitas Programme	384.0	2,997.4	6,021.0		OKM
Művészetek Palotája (Palace of Arts)	2,002.6	8,262.8	8,509.4	31.3*	OKM
M5 motorway		36,949.7	39,023.3	537.8	GKM
M6 motorway: Érd–Dunaújváros		20,975.0	14,125.8	193.6	GKM
M6 motorway: Szekszárd–Bóly, M60: Bóly–Pécs				266.1	GKM
M6 motorway: Dunaújváros–Szekszárd				208.3**	GKM
Szombathely, prison			1,638.6	40.3	IRM
Tiszaölök, prison		505.7	2,164.4	39.4	IRM
Sport 21 framework program		292.5	1,363.9		ÖTM
Altogether PPP	2,386.6	69,983.1	72,846.4	1,327.2	
Share in the HTK fund	41%	47%	46%		

Source: PM HTK records, as of January 31, 2008.

Notes: * Investment value.

** Maximum value of commitment assumed under decree number 96/2007 (X.31.) OGY (National Assembly) (currently, the project is under public procurement procedure).

Note that the Sports 21 program reflects partial state subsidies of municipal gymnasias and swimming pools. Another interesting factor is that even with the motorway projects that consume nearly two-thirds of the central government's PPP budget, the state used less than half of the funds available for PPP commitments as of 2008. This reflects a difficulty in matching projects with priority development goals, in meeting the strict Eurostat conditionalities, as well as objectively showing that the PPP arrangement is more economical, i.e., provides more value for money, than the traditional forms of financing and project implementation.

Other service contracts, such as concessions for water, wastewater, and solid waste treatment; the contracting out of routine services such as security and housekeeping; operational leases for capital equipment and for energy and transportation prevail at the

municipal level. These are governed, however, by the Concession Law, Local Government Law, and sectoral laws, and do not really meet the criteria of being PPP arrangements. These arrangements are not long-term purchases of services by the public sector, where the private sector finances and creates an asset, takes most of the risks, and hands over a depreciated asset 15 to 25 years later.

If we ignore the early concession arrangements that were later determined not to be PPP arrangements, given that all of the risk was borne by the state, then only the data provided by the Interministerial Committee is useful. Between 2003 and the end of 2006, 85 project proposals were reviewed by the Committee. These projects included prisons, modernization of courthouses, university dormitories, theaters and cultural facilities of national importance, motorways, and studios for the state-owned TV network. In 2005, the Local Government and Sports Ministries began to propose sports facilities, swimming pools and gymnasias for municipalities with partial state funding of PPP fees. This program was aimed at constructing sports facilities in municipalities that were underserved. Discussed in detail elsewhere, very few of these facilities were built using the Sports 21 scheme, since municipalities considered the PPP fees to be too high, even after accepting the subsidy. And many municipalities of various sizes decided to use traditional borrowing and concessions contracts, hence realizing 30–50 percent savings. Of the 133 projects under consideration between 2003 and 2006, only 30 were actually contracted. The potential net present value of the 133 projects was about EUR four billion at the end of 2006 and EUR 5.2 billion by the end of 2007.

According to the Committee's data from March 2008, 67 PPP projects were under way in Hungary. Of these, the M6 motorway⁸ accounted for over two-thirds of the funds committed. Further examples of "live" PPP projects include the Palace of Arts in Budapest, two prisons, 10 dormitories, 13 dormitory refurbishments, 15 research centers, seven gymnasiums, four training swimming pools, and one municipal sports complex.

The PPP Committee's guidelines suggest a risk matrix taking planning/construction, availability, and demand risk into account. These, of course, are only those risks associated with the Eurostat standards, and should be considered as the minimum.

3. TYPES OF RISKS

3.1 Classification Risk

The most evident risk—or classification risk, faced by PPP project sponsors in Hungary, regardless of whether they are central ministries or municipalities—is that their project is classified according to Eurostat standards as being state debt, or in the case of municipalities, the project's financing scheme needlessly burdens its debt service capac-

ity. Since PPP payments are not yet regulated by national law at the municipal level, their inclusion in debt limits or in a separate category of obligation as exists at the state level already means municipalities face significant policy risk if they engage in projects that meet PPP standards. Choosing a PPP arrangement only to avoid an accounting or statistical classification is a potentially dangerous practice that is to be avoided through transparent instructions for conducting value for money, and public sector comparator analysis. This is the point at which the private sector has a dominant advantage over the public sector.

Thus, relevant and useful PPP guidelines for calculating value for money and doing the public sector comparison are areas where “liberalized” regulatory frameworks could help municipalities. PPP project review and approval by the central state are not needed if the framework is clear enough to be applied by a municipality acting in its own interest. (Certainly, there is some evidence that Hungarian municipalities have rejected PPP projects on the basis of cost and have gone ahead with other models of financing/operation in order to implement their projects).

Since PPP obligations are not regulated at the municipal level, and if they are not deemed to be classical forms of municipal debt such as leasing, bank loans, or bond payments, there is no obvious advantage to using the PPP model versus public borrowing. As stated before, PPP is used at the state level to take future payment obligations off the balance sheet and to prevent investment expenses from burdening current deficits. There is no incentive at the municipal level to “hide” this kind of debt, since unlike at the central level, PPP obligations are not recorded as debt nor are they regulated either by the annual budget law or by the treasury.

In other words, the large risk facing a Hungarian municipality is that assuming a PPP obligation will be one and half times to twice as expensive than standard bank or bond financing. For this reason, when municipalities compare the all-inclusive cost of PPPs versus simple borrowing and the offer of an operational concession, the latter wins. Thus, PPP arrangements are routinely rejected by the more sophisticated municipalities.

In contrast, the decision to go forward with a PPP project at the central level bears the risk that *ex post facto* the Statistical Office or even Eurostat could reclassify the project as sovereign debt. Hungary had to re-tender motorway concessions since the EU did not accept them as genuine PPP projects, and the government’s deficit and debt ratio reduction plan was threatened. So this “inception risk” at the central level means the risk of reclassification, whilst at the municipal level a decision to go ahead with a PPP without the appropriate calculations means an excessive cost for private provision that could be done for much less with traditional financing and eventual contracting out in non-PPP ways.

3.2 Risk Matrix: Construction, Availability, and Demand

The guidance document's "risk matrix" (MoE 2004) is useful not only at the central, but also at the municipal level for segregating construction, availability, and finally demand risk. Identifying, pricing, and allocating these three types of risk are a good practice for municipalities regardless of the type of project they are proposing.

1. Planning and works risks

- Who is responsible for planning the investment?
- Does the contract primarily specify the volume and quality of the service or also requirements relative to the characteristics of the assets necessary to provide the services (size, design, and technical quality of the assets to be used)?
- Is it the state or the PPP contractor who bears the risks emerging during the implementation of the investment (e.g., risks of increased costs, financing risks due to faulty design/execution)?
- What sanctions can be applied by the customer in case the investment fails, is delayed, or is implemented inadequately?

2. Availability risk: Is it the state or the PPP contractor?

- Who bears the risks emerging during operation (e.g., risks due to breakdowns, gaps in operation, or natural disasters)?
- What sanctions apply if the contractor is unable to ensure the availability of the resources at the quality specified in the contract for a temporary period?
- Can it happen that the state will have to provide contributions to financing maintenance of the assets?
- Which party is responsible for maintenance and insurance of the assets?
- What are the sanctions applied by the competent ministry in case service quality is inappropriate?
- Who bears the risks of increased operational costs?

3. Demand risk

- Who bears the demand risk?
- Will the private partner be eligible for compensation in case the demand is lower than expected or specified in the contract?
- Who bears the costs emerging from demand higher than expected or specified in the contract?

- May the contractor use the assets created to provide services in the framework of its business activities for a third party?

Proper use of the three risk categories enables an analyst to determine whether a project meets Eurostat standards for being off the state's balance sheet. In other words, the private partner is expected to bear all of construction risk, and one of either demand or availability risk.

3.3 Approaches to Risk Assessment

The Hungarian SAO has decided to adopt the National Audit Office's "Framework for Evaluating the Implementation of Private Finance Initiative Projects" (SAO 2006). The NAO-SAO approach evaluates six separate stages of any PPP project. These are: strategy, tendering, finalizing the contract, pre-implementation, the initial implementation period, and advance implementation.

Most important for any regulatory framework would be the ability to strategically preempt or promote projects that serve a particular national development plan. The aspects to consider under "strategy" are the following:

- Suitability of project to business needs
- Appropriateness of PPP for the public sector stakeholders
- Support of the project by partners
- Quality of delivery of project
- Optional balance between cost and quality
- Effective risk allocation

These criteria appear to be "screening" criteria to be used before a project is actually started. The rest are more appropriate in an *ex post facto* situation where a supreme audit organization is likely to be involved.

3.4 Stakeholders' Risks

There have not been any failed PPP projects in Hungary where the consequences of the risks have been made explicit to the stakeholders. The risks identified above (classification, construction, availability, and demand) for the most part are shared by the sponsor, that is the municipality, and by the private contractor. An obvious financial risk for both parties involves the risk of default, that is, if the municipality cannot pay

the entire or even a part of the availability fee at some time during the 15–30 year term of a typical PPP project. Both parties face the risk of reduced or even changed demand for the service being provided. The private sector's suppliers face most of their risk up front in the project. But by assumption, the private contractor will pay the suppliers and construction contractors on time, or else it will not reach the implementation phase and gain access to the long-term cash flow that is promised in the deal. Thus, the risk faced by suppliers and other subcontractors seems to be minimal.

The population, citizens, and customers face the risk of ultimate responsibility for municipal obligations over the long run. In other words, will local taxes be increased, user charges be raised, and the level of services altered in order to make availability payments over the long run? There are thus potential tradeoffs in the prices and availability of other public services that are not related to the original service being provided through the PPP. The user of the service also faces the risk of declining quality that, of course, should be regulated by contract. Other local stakeholders, perhaps originally competitors to the service being offered by a PPP face the ultimate risk of losing their market over a very long run. If existing local businesses are displaced by the new service, the municipal budget also faces the risk of adjustment assistance, unemployment payments, and other forms of unrest.

As some of the Hungarian examples have shown, the actual bids that arrive in the public procurement process are sometimes a multiple of the amount expected in the original PPP structure. This happens rather routinely and is not only a function of inexperienced sponsors. Rather, the private bidders decide to pass on all risks to the public sector through aggressive pricing, or have an exaggerated view of risk due to a lack of experience. Either way, many proposed PPP projects at the municipal level in Hungary (Sports 21 program gymnasia, pools, etc.) have failed at the point of tendering when bids simply came in at an exaggeratedly high price.

Finally, the value for money analysis skills of the public sector are usually lacking in Hungary. Despite guidelines on discount rates to use when comparing net present values, this aspect of analysis is not well documented nor well supported by methodological guidelines or handbooks. Given the sensitive nature and complication of these calculations that assume certain cost and revenue trends will continue for the next 15–30 years, municipalities at least conduct this analysis in the simplest of terms, attempting to use the lowest possible cost of borrowed funds and assuming a fully owned municipal enterprise to make the comparison. Often, the project availability fee “offered” by the Sports 21 program or by a private vendor is simply too high in nominal terms to be acceptable to municipalities, despite the multitude of potential advantages that are packaged in a PPP proposal. In other words, this is still an undeveloped frontier area.

4. LESSONS LEARNED FROM HUNGARY

4.1 Regulatory Lessons Learned

The Interministerial PPP Committee has proposed a standard set of documents to be used for PPP packaging at any level of government. These proposed documents have not yet been introduced nor approved, but could be useful in other transition countries. These documents (taking into account the contents detailed earlier in this report) include:

- Preliminary evaluation form (to be used by approving authority)
- Project template, business plan template, and project data sheet
- Risk matrix template (risk allocation, financial, compliance, etc.)
- Approval form for “state aid” filled in by appropriate agency
- Approval form to be filled out by the committee
- Sample contracts
- Treasury or Ministry of Finance reporting form where appropriate
- Biannual reporting forms

Naturally, a set of detailed instructions would be required for each component in the documentation package.

4.2 Evaluation Matrix

The most practical approach to a Go/No go or somehow scaled evaluation system would be to adopt the risk allocation matrix (construction, availability, demand) checklist for basic financial analysis, that is, to determine whether the public cost or the private route have a lower cost net of revenues in present value terms.

When conducting the calculation calling for a public sector comparator, it is necessary to have specific data on the following:

- Construction cost (what is the projected construction cost, usually appearing in the first three years of the project?)
- Annual availability fee: this consists of two parts usually, that is, an availability fee that is connected to capacity but not to a level of usage. This is where capital cost is realized, and assumes a level and quality of available service. The second component could be a shadow toll, that complements revenue that is actually collected from users.

- Present value of annual fees, using the discount rate that is called for by regulation. Selection of the comparative private sector discount rate is, of course, critical to making the correct choice for the public sector.

5. EXAMPLES AND VESZPRÉM CASE STUDY

Before discussing the specific example of the Veszprém sports arena, that started out as a state-sponsored PPP project and ended up being fully financed with a bank loan and the use of several municipal enterprises, we describe the context in which the government of Hungary attempted to initiate genuine PPP projects at the municipal level, 2004–2007.

5.1 Sports 21 Program

The Interior Ministry, through its sports portfolio, decided to launch a sports facility construction process for underserved areas. Municipalities would have received a partial subsidy from the state budget to pay the availability fees to private operators of swimming pools, gymnasia, and other facilities. An extract from the Interministerial Committee' post-mortem on the program follows:

The Government launched the Sport XXI Facility Establishment Program through the Governmental decision number 1055/2004 (VI.8) on the transformation of the development and operating system of sports facilities. The programme covered three sub-programs where the IM PPP Committee carried out project opinionating tasks:

- “Modern gymnasiums everywhere” sub-program (“gymnasiums”),
- “Educational swimming pools in all small regions” sub-program (“children’s swimming pools”),
- “With sports for communities” sub-program (“sports halls”).

—Báger 2007, 12–13

The program was closed down as of January 31, 2007, and no applications can be made for new projects. In December 2006, the Interministerial PPP Committee made a summary report about the experiences related to the program of the National Office for Sports, which was sent to the leaders of the ministry portfolios and institutions dealing with PPPs. The most important critical remarks concerning the program were as follows: a lack of actually implemented sample projects (the sample projects were only one step ahead of the other projects); small project size; and low competition upon the requests for bids. All these elements together rendered the PPP scheme relatively

expensive, and for this reason, several local governments stepped back from the program and from contracting (finally, 37 out of the planned 121 projects will be implemented).

Projects can be implemented economically only on a large scale (in Hungary: above an investment value of minimum about EUR four million = HUF one billion), or in a real package (totally identical project documentation and contract).

Tables 3.2 and 3.3 sum up the main features of the National Office for Sports and Ministry of Local Government and Regional Development projects.

Table 3.2

The Main Features of the National Office for Sports and Ministry of Local Government and Regional Development Projects

	Under approval	Effective contract signed	In operation	Total
Gymnasium	3	8	7	18
Educational swimming pool	—	14	4	18
Sports hall	—	1	1	1
Total				37

Source: Status Report submitted to the IM PPP Committee, January 2008.

Table 3.3

Realized and Operating Facilities in the Program

Settlement		Gross state charge contribution payable in 2007 (HUF thousands, gross)	Gross state charge contribution payable in 2008 (HUF thousands, gross)
Gymnasium	Debrecen	19,440	23,794
	Magyaratád	22,134	23,794
	Szenna	22,134	23,794
	Somogyjád	38,500	41,436
	Kozármisleny	48,349	56,864
	Nagybajom	30,152	41,436
	Dédestapolcsány	5,533	23,794
Educational swimming pool for children	Mohács	29,139	57,296
	Bácsalmás	10,004	32,354
	Szigetvár	4,393	57,296
	Ibrány	0	53,843
Sports hall	Kiskunfélegyháza	11,385	48,956

Source: Status Report submitted to the IM PPP Committee, January 2008.

The list above hides the fact that the cities of Békés, Gyöngyös, Jászberény, Szigetszentmiklós, Veszprém, and Mosonmagyaróvár declared their tenders to be invalid given that the prices exceeded all expectations. Veszprem, as indicated earlier, just opened its multifunction sports arena in July 2008, at a cost at least one-third less than the PPP version, using its own firm and bank financing. The city of Gyöngyös's sports arena was eventually built using private financing, without the state subsidy, for a lower cost than was proposed under the central government program. While not on the list above, Hódmezővásárhely opened its multifunction sports arena in August 2008, using the Sports 21 PPP program. A private operator built and will operate the system for 15 years, for an annual availability fee of HUF 120 million (about EUR 500,000), then hand off ownership to the city. The central government's Sports 21 program will pay 42 percent of the fee. It seems Hódmezővásárhely is the exception to the rule, as more municipalities have rejected this program or have gone forward alone than have accepted it.

Press reports on joint efforts between the public and private sectors abound in Hungary, and most reports claim that these are "PPP" projects, even if the Eurostat and other criteria are not met. Since there is no central review and approval nor a reporting system for projects labeled as being PPPs at the municipal level in Hungary, it is very difficult, as the SAO has also said, to guess at the scale, type, and number of these endeavors.

5.2 CASE STUDY: VESZPRÉM SPORTS ARENA

The Sports 21 program was designed to partially subsidize sports facilities at the municipal level, using a state budget allocation that required the Interministerial PPP Committee to get involved. The initial plan was that each county capital would construct a multifunction sports arena, much like the one already in existence in Debrecen. Of the remaining 18 county capitals, only nine began to plan arenas using the Sports 21 program. Two dropped out of the program early, six invalidated procurement processes, and only Veszprém actually built an arena, albeit not using the state-supported form of PPP, instead developed their own model (to be described subsequently). In general, the public procurement process produced price bids that were 50–60 percent above the amount planned in the tender documentation. This demonstrates significant risks perceived by the private sector that are shifted to the public sector through higher prices.

Veszprém, a county capital with a thousand-year history, is located in central western Hungary, about 20 kilometers north of Lake Balaton with a population of 60,000. It is home to a professional handball team, MKB Veszprém, that routinely hosts teams from across Europe. The city decided in the mid-1990s to look into a multifunction sports arena, and found a model in Celje, Slovenia, that served as a blueprint for the technical plans. However, the arena was not planned from a financial perspective until

2005, when the city council decided to take part in the government's Sports 21 program and apply for the PPP subsidy.

The first tender was announced in early 2005, when four bidders submitted proposals for a 15-year PPP project that would cost HUF 15 billion (about EUR 60 million). The city's calculations called for a total 15-year cost, including construction and operations, of no more than HUF nine billion (EUR 36 million). This tender was repeated in September 2006, one month before the October 2006 municipal elections that resulted in a complete change in power, including a new mayor and the victory of the former opposition party. The September 2006 tender had four bidders, three of which, unfortunately for the city, had to be disqualified for formal reasons. This tender called for a HUF 4.5 billion construction cost, and about a HUF 4.5 billion operational cost over 15 years.

The only bidder submitted a price that was close to the city's objective. Instead of being satisfied with its own offer, the winner attempted to ratchet the price up to over HUF 13 billion, and the city was unable to settle a contract with them. In the meantime, construction started in September 2006, before there was a final construction permit. The cancellation of the last tender under the PPP scheme, the start of illegal construction, and the local elections had the effect that the city continued to build the arena with no valid winner, even after the change in administration. In November 2006, the new administration temporarily halted construction.

The former administration and opposition traded places in October 2006. But there was a consensus, despite all the public controversy, that Veszprém had to finish its arena by 2008 without using the government's PPP scheme, however. Construction resumed in May 2007, after the city paid a fine to the public administration office (a state level institution). The most interesting aspect is that the city developed a financial scheme to avoid using PPP, an option they considered too expensive on the basis of two failed public tenders.

The arena⁹ was ceremoniously opened in July 2008, at a construction cost of HUF 4.5 billion or EUR 18 million. This cost was funded entirely by a bank loan to be repaid over 15 years. In addition, the availability fee added another HUF 4.5 billion over 15 years, making the total nominal cost HUF nine billion (EUR 36 million). The arena, a larger version of the one in Celje, Slovenia, has 6,000 seats, and 2,000 square meters of floor space for events. In addition, it has a ballroom that can seat 650 guests. The city has reserved 70 percent of the space and time for itself, with the balance made available to the handball team and other professional sports.

The Financial Scheme

The 100-percent Veszprém Communal Services Company that serves essentially as a holding firm for all property and services except water and sanitation, borrowed HUF 4.5 billion from a commercial bank. This communal company also owns the land upon which the arena was built. The city's procurement tender called for the purchase of the

right to use an arena that meets the specifications of the one that was to be built. The “winner” of that tender to provide the service was Csarnok (Arena) Ltd., a firm entirely owned by Veszprém Communal Services. The city paid Csarnok Ltd. an availability fee equal to the estimated “loss” from operations, taking into account the commercial revenue Csarnok Ltd., could have from events at the arena.

Debt service, *per se*, does not come directly from the city budget. Of course, the city budget guarantees the debt service on the HUF 4.5 billion owned by the Communal Company, but cash moves from the budget to the Communal Company, and ultimately to the bank, in a novel way. The city agreed to increase the subscribed capital of the Communal Services Company by about EUR two million per year until the loan was repaid. This does not count as debt service in the city budget, and thus does not hinder the city’s debt limit. This transaction does not incur a VAT liability either. The fee that the city pays to the operating company (Csarnok Ltd.) does incur a VAT liability that the city cannot get refunded. So the city is using a capital transaction on an annual basis to fund the debt service of an enterprise that it owns. The construction contract is between the holding company and the operating company, while the bank loans is between the bank and the holding company. The operating company is expected to break even, including the service fee and other revenues.

The original PPP scheme became a long-term purchase of “arena services” by the city from its own enterprise, Csarnok Ltd., with financial intermediation by another city enterprise, the asset management and communal service company. Of course, the scheme as described is more complicated in reality, but reflects financial sophistication and creativity that does not exist at the state level. In the end, the arena was built for the original price, and seemingly will operate for 15 years as planned. There is even a chance that the operating company will make a profit from the special events, a profit that will show up on the balance sheet of the holding company and the operating company. Those retained earnings will be available to the city for other projects in the long run.

Lessons from Veszprém

Given that there was a dream in Veszprém to build a sports arena that spanned several electoral cycles, the existence of the Sports 21 PPP program proposed by the Sports Ministry was enough to spur several ill-fated public tenders. There was no doubt that the political leadership and the experts behind them who routinely played the role of opposition and “ruling” power at the local level, had developed a technical and financial consensus that the arena would be built. All the public controversy and grandstanding notwithstanding, the local stakeholders had calculated, and agreed that the price of HUF nine billion was acceptable to them, and any offer over that, as in the case of the two attempts at using the Sports 21 subsidy, was not acceptable. The local stakeholders had also agreed in advance to the extent of what were to be the acceptable direct budget transfers in the form of an availability fee to be paid to the operator. This is not always

the case. Finally, the capital increase over 15 years to cover the loan repayment was simply a stroke of genius that survived the change in administration in October 2006. The most important lesson is continuity at the stakeholder level, and an agreement on the acceptable cost, and the ultimate goal to be achieved. *The PPP attempt was simply outside interference that stimulated more creative thinking at the municipal level.*

A second important lesson was that, in a tendering situation, if there is only one winner, that winner will attempt to maximize its position, even though tendering documents were clear about total cost expectations. Such a bidder should not press its luck excessively. But since there was an agreement among all the parties at the municipal level about the objective and price, the bidder overplayed its hand and lost in the end. Political momentum, the desire to build a monument to the former mayor, and stakeholder interests in the end were important factors in developing a complicated financial plan that, by definition, will span at least three more election cycles.

According to several stakeholders, the current HUF nine billion option was not optimal either, since some estimates that an overall cost of HUF six billion may have been possible over the 15 years. But the two PPP-based public tenders established a baseline of HUF nine billion, and this was accepted by all the parties concerned. In a sense, the ultimate solution was shaped by the last failed PPP tender. In other words, the solution selected was better than any of the PPP options reviewed, but suboptimal were the city to start from a blank slate.

Finally, given that, unlike the state, the city of Veszprém and others like it are creditworthy, their motivation should be value for money above all. This goal was not met given the detour into subsidized PPP schemes proposed at the state level. At the secretariat of the PPP Committee, the experts are satisfied with the national level regulations and procedures. When queried as to how similar procedures could apply at the municipal level when state funds are not being committed, the answer was that each level should develop its own process.¹⁰ This comment, not too helpful, reflects a major feature of public finance in Hungary that is not likely to change very soon. That is, municipalities do not need the approval of the state in any form to incur obligations or debt, even if that obligation meets Eurostat PPP criteria. However, for countries where an agent of the state, represented most likely by the Ministry of Finance, is deeply involved in debt decisions, some standard for evaluating, ranking, and approving PPP projects should be explicitly developed.

The financial sector, as the Veszprém case shows, will work very closely with the public partner to “outwit” the formal constraints of a regulated PPP process. Therefore the emphasis should switch to projects that are sustainable in every sense, and are not primarily motivated by rent seeking (getting a partial state subsidy) or by avoidance of state debt restrictions (the usual justification at the state level for PPP versus traditional financing).

6. CONCLUSIONS

This study initially takes a broad approach to the method of involving private service providers and capital in delivering public infrastructure. Before Hungary's EU accession in 2004, there was practically no legal framework in Hungary that specifically defined what a PPP is. Therefore, many projects that were heralded as examples of PPP in the 1990s and early 2000s have to be "relabelled" as quasi-disguised public debt or simple purchases of long-term services under a variety of financing schemes.

Even though there is no single law on PPPs in Hungary—and the Concessions and Procurement Laws, respectively, do not mention PPPs at all—there are three perspectives from which PPPs are regulated:

- First, the procedural steps to be taken by project sponsors, such as ministries and central government agencies, are defined in a series of government decrees and decisions, but not by law.
- Second, these same decrees and decisions require the compliance of proposed central government PPP projects with national development priorities that are proposed by the National Development Agency, then approved by the cabinet twice a year.
- Third, since the PPP projects that are regulated through these decrees and decisions are all supported by the central budget (not by municipal budgets), the annual Budget Act, as well as the Budget System Law regulate the procedure to be followed when the state assumes a new liability (not necessarily a debt given that these investments are long term purchases of services and not borrowing if they meet Eurostat standards).

PPPs are not specifically regulated in Hungary at the local government level. What was apparent from previous investigations by the SAO is that at the municipal level most projects are poorly prepared, there is no examination of efficiencies, and that municipalities faced a capital budget deficit, and wished to avoid burdening their borrowing limit when they attempted a PPP approach to obtaining a service.

The most evident risk—"classification risk," faced by PPP project sponsors in Hungary, regardless of whether they are central ministries or municipalities—is that their project is classified according to Eurostat standards as being state debt, or in the case of municipalities, the project's financing scheme burdens its debt service capacity needlessly. Since PPP payments are not yet regulated by national law at the municipal level, their inclusion in debt limits or in a separate category of obligations as exists at the state level already means municipalities face significant policy risk if they engage in projects that meet PPP standards. Choosing a PPP arrangement only to avoid an accounting or statistical classification is a potentially dangerous practice that is to be

avoided through transparent instructions for conducting value-for-money and public sector comparator analysis.

PPP project review and approval by the central state are not needed if the framework is clear enough to be applied by a municipality acting in its own interest. (Certainly, there is some evidence that Hungarian municipalities have rejected PPP projects on the basis of cost and have gone ahead with other models of financing/operation in order to implement their projects). In other words, a large risk facing a Hungarian municipality is that assuming a PPP obligation will be one and a half to two times more expensive than standard bank or bond financing. For this reason, when municipalities compare the all-inclusive cost of PPPs versus simple borrowing and offering an operational concession, the latter wins, and PPP arrangements are routinely rejected by the more sophisticated municipalities.

Finally, the value-for-money analysis skills of the public sector are usually lacking in Hungary. Despite guidelines on discount rates to use when comparing net present values, this aspect of analysis is not well documented nor well supported by methodological guidelines or handbooks. Given the sensitive nature and complication of these calculations that assume certain cost and revenue trends will continue for the next 15–30 years, municipalities at least conduct this analysis in the simplest of terms, attempting to use the lowest possible cost of borrowed funds and assuming a fully-owned municipal enterprise to make the comparison.

The most important lesson from the Veszprém sport arena is the importance of continuity at the stakeholder level, and an agreement on the acceptable cost, and the ultimate goal to be achieved. A second important lesson is, that in a tendering situation, if there is only one winner, that winner will attempt to maximize his position, even though tendering documents were clear about total cost expectations. According to several stakeholders, the current HUF nine billion option was not optimal either. In other words, the solution selected was better than any of the PPP options reviewed, but suboptimal were the city to start from a blank slate.

Finally, given that unlike the state, the city of Veszprém and others like it are creditworthy, their motivation should be *value for money* above all. This goal was not met given the detour into subsidized PPP schemes proposed at the state level. For countries where an agent of the state, represented most likely by the Ministry of Finance, is deeply involved in debt decisions, some standard for evaluating, ranking, and approving PPP projects should be explicitly developed. The financial sector, as the Veszprém case shows, will work very closely with the public partner to “outwit” the formal constraints of a regulated PPP process, and the emphasis should switch to projects that are sustainable in every sense, and are not primarily motivated by rent seeking (getting a partial state subsidy) or by avoidance of state debt restrictions (the usual justification at the state level for PPP versus traditional financing).

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List of Interviews (September 2008)

László Németh, Chief Advisor, Development and Operations Office, City of Veszprém.

István Mátyás, former City Council Member and Chairman of Public Procurement Committee (2004–2006), City of Veszprém.

Ferenc Hartmann, former chairman of Economics Committee and Deputy Mayor for Finance, City of Veszprém. Currently Socialist Party faction leader.

Lajos Baumgartner, Chairman, Economics Committee, Veszprém City Council, 2006–present.

Gábor Zongor, Secretary General, Hungarian National Association of Local Authorities.

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NOTES

- ¹ Mr. László Németh, Operations Clerk, Veszprém City, Urban Development and Communal Services Department.
- ² These are: “New Decision of Eurostat on Deficit and Debt: Treatment of Public-Private Partnerships.” In Eurostat News Release, 18/2004 and “ESA 95 Manual on Government Deficit and Debt—Long Term Contracts between Government Units and Non-government Partners.” The 2008 version of the Hungarian Economics Ministry’s Guidance Document covers the issue of ESA 95 reporting, debt and deficit implications of PPP projects at the central level.
- ³ The Interministerial Committee was disbanded by a government decree on October 1, 2009. All of its functions were transferred to a new unit within the Ministry of Finance. At this point in time (January 2010), it is not apparent why this move was made, nor how the procedures will change, nor how evaluations of new PPP projects would be affected.
- ⁴ As indicated previously, the functions of the committee have been assumed by a section in the Ministry of Finance as of October 1, 2009.
- ⁵ In regulatory environments like the former Yugoslav states of Serbia or Macedonia, where ministry, cabinet, or other approval is required for a municipal commitment of funds or for borrowing, the guidelines are particularly useful.
- ⁶ Attempts by the national government to build sports facilities, swimming pools, etc., on a joint venture basis with municipalities has been met with much resistance on the part of municipalities, who realized that their healthy borrowing capacity allowed them to complete such investments at a lower cost, than if they sign service contracts under a PPP scheme that ties up a portion of the budget for 15–20 years.
- ⁷ Budget deficits for operational costs are not allowed at the municipal level (but exist in disguised forms). Capital investments may be financed from bond sales or bank borrowing, and this type of borrowing does not need any approval from the national level (unless a

sovereign guarantee is requested). Rumors of restrictions on municipal borrowing in late 2007 led to a boom in bond issues, where the bond debt of municipalities essentially doubled in six months. By all measures the municipal sector is far from reaching its maximum borrowing capacity, and this type of “preemptive borrowing” is expected to continue in the prevailing uncertain regulatory environment in 2008.

- ⁸ The M6 motorway (Budapest to Pécs) project received the “PPP of the Year, 2007” award from *PFI Magazine*. Despite such press, the project has been criticized for excessive cost (tunnels bored into low hills, too many viaducts) and a rather secretive set of feasibility studies. The discount rates and other assumptions used to model the PPP approach versus the public sector comparator may have distorted the results. The underlying calculations remain secret, which is not a good precedent.
- ⁹ Available online: <http://www.veszpremarena.hu>.
- ¹⁰ Comments made during a telephone interview with Judit Szöllőssy, Secretariat of the PPP Committee, Budapest, September 2008.

Public-private Partnerships in Poland

Overcoming Psychological Barriers and Rigid Regulation

Rafal Stanek and David Toft

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EXECUTIVE SUMMARY

This paper describes the framework of public-private partnerships under which public services and utility projects can be carried out in Poland.

Encouraged by the principles of the European Commission's *Guidelines for Successful Public-private Partnerships* published in 2003, and the passing of the Community Law on Public Contracts and Concessions in 2004, Poland began to develop its own regulations and create a legal regime governing the implementation of public-private partnerships (PPPs).

The first piece of legislation, the Polish Public Procurement Law, was passed in 2004, later accompanied by a trickle of resolutions from the Ministry of Finance and some sectoral laws on concessions, public services, and businesses that eventually culminated in the new Public-private Partnership Law that came into force in 2009. Unfortunately, due to various flaws and shortcomings, a previous law governing PPPs—along with its implementing legislation—was not used at all despite being in force for about three years previously. Only the future will tell if the new legislation from 2009 will be the spark needed to accelerate PPPs in Poland.

Assumed to alleviate pressures on public debt and local budgets, while usually bringing about gains in new infrastructure and efficiency in the provision of services, the PPPs in Poland illustrated in this paper include the establishment of a water and wastewater management company in Gdańsk, another joint stock company established to manage the same sector in Bielsko-Biała, and two projects for street lighting and underground parking in Kraków. These examples can be typified as the following PPP models: the creation of new entities held by the public and private parties (companies with mixed capital), contracting based on the Public Procurement Law, Build-Operate-Transfer (BOT) investments, and concessions.

An analysis of the Polish market for developing various forms of PPPs based on these cases reveals that municipal and network infrastructure projects, along with popular improvements to public sports and recreation facilities, and small PPPs under a value of EUR 10 million make up the bulk of PPP activities.

Any expansion of these agreements to include healthcare or major infrastructure projects in Poland requires more experience in planning, developing, and managing on the part of the local, regional, and national government, while some issues need to be resolved regarding administrative red tape, mistrust and barriers to implementing PPPs that also safeguard the public and private sectors' interests in a mutually rewarding outcome for all.

1. EU DOCUMENTS IN THE CONTEXT OF PPP IN POLAND

1.1 Guidelines for Successful Public-private Partnerships

The main document of the European Commission on PPPs is the *Guidelines for Successful Public-Private Partnerships*, published in 2003. The document focuses on five areas (EC 2003):

1. PPP structures, suitability, and success factors
2. legal and regulatory structures
3. financial and economic implications of PPPs
4. integration of grant financing and PPP objectives
5. conception, planning, and implementation of PPPs

The *Guidelines* place much stock in the private sector's ability to conduct tasks in a manner that effectively ensures efficient management of assets, even in the case of traditionally public functions (EC 2003). The European Commission hopes that PPPs can play a key role in the development of new member states through a more effective use of assets and public funds. The underlying theory is that PPPs will make it possible to raise investment funds in an amount unattainable under traditional forms of public sector financial management, without excessive support from the EU budget or those of its member states, and by reducing grant financing to an auxiliary role. Finally, by adding flexibility to infrastructure development, based on cooperation with the private sector, the intent is to decouple as far as possible public infrastructure investment from EU budgetary cycles.

The applicability to the situation in Poland of the European Commission's desire for public authorities to cooperate more openly with strong private sectoral actors is clear, as the need continues to be great for investment in sectors that are crucial to economic development (in particular, the transportation, energy, water and wastewater, and telecommunication sectors) as well as in social infrastructure, in particular health care, education, and public safety.

1.2 The Green Paper and Community Law on Public Contracts and Concessions

The Community Law on Public Contracts and Concessions of April 30, 2004 does not lay down any special rules governing PPPs. However, any act, whether contractual or unilateral, whereby a public entity entrusts the provision of an economic activity to a

third party, must be examined with respect to the rules and principles resulting from the Lisbon Treaty. Of particular importance are the principles of freedom of establishment and freedom to provide services, which encompass in particular the principles of transparency, equal treatment, proportionality, and mutual recognition (EC 2004). The Green Paper draws the distinction between:

- i) PPPs of a purely **contractual** nature, in which the partnership between the public and private sectors is based solely on contractual links, and
- ii) PPPs of an **institutional** nature, involving cooperation between the public and private sectors within a distinct entity (EC 2004).

Under the contractual partnership, two basic models can be distinguished:

- The **concession model**, characterized by a direct link between the private partner and the final user: the private partner provides a service to the public, “in place,” though under the control of, the public partner. Another feature is the method of remuneration for the joint contractor, which comprises user charges, if necessary supplemented by subsidies from public authorities. In this model, the act of awarding the contract is defined as a “concession.”
- **A private partner carries out and administers an infrastructure for the public authority.** In this model, the remuneration for the private partner does not take the form of user charges, but of regular payments by the public partner. These payments may be fixed or variable, for example, calculated based on the availability or level of use of the works or related services. In this model the act of awarding the contract is defined as a “public contract” (Ministry of Economy 2007).

Institutionalized PPPs involve the establishment of an **entity** held jointly by the public party and the private partner. The joint entity is tasked with ensuring the delivery of a work or service for public benefit. In member states, public authorities sometimes have recourse to such structures, in particular, to administer public services at the local level (for example, for water supply or solid waste collection services). An institutionalized PPP can be put in place, either by creating an entity held jointly by the public sector and the private sector, or by the private sector taking control of an existing public undertaking.

The PPP models described in the Green Paper are generally present in Poland, in particular, referring to concessions and public contracts. The Polish Public Procurement Law concerning the selection of a private partner follows the approach recommended in the Green Paper, which in particular refers to the competitive dialogue procedure, introduced into Polish law in 2007.

2. THE PUBLIC-PRIVATE PARTNERSHIP SYSTEM IN POLAND

As Polish society and its economy develop, local governments face increasingly complex tasks. Local governments are the primary focus in this study because they are assigned an increasingly greater range of public tasks that are not always covered by commensurate funding. This results not only in a decrease of resources available for spending on capital investment projects, but also the necessity to efficiently use available resources for the implementation of these new tasks. Local governments, charged with performing public tasks, at times without adequate funding, and at the same time needing to comply with environmental protection regulations on solid waste management, water quality, and wastewater management, are forced to increase public debt to finance these tasks and investments (Ministry of Economy 2007).

2.1 Deficit and Public Debt

Given that PPPs are intended to relieve pressure on public budgets (they would not be counted as a part of public debt) and the aforementioned increase in local government tasks without commensurate financing, it is instructive to briefly examine public debt in Poland.

The deficit and public debt of national and local government institutions in the period from 2004 to 2007 are presented in Table 1, below.

Table 4.1
Public Debt in Poland, 2004–2008 (PLN million)

Specification	2004	2005	2006	2007	2008
Gross Domestic Product (GDP)	924,538	983,302	1,060,031	1,175,266	1,271,715
Deficit of state government and local government institutions sector	52,685	42,358	41,131	22,131	49,537
Percent GDP	5.7	4.3	3.9	1.9	3.9
Debt of state government and local government institutions sector	422,386	462,742	505,149	527,520	598,402
Percent GDP	45.7	47.1	47.7	44.9	47.1

Moreover, according to the forecast of the Ministry of Finance, the deficit of this sector in 2009 will amount to 6.3 percent of GDP, while public debt will amount to 51.2 percent of GDP (Main Statistical Office 2008).

2.1.1 Situation of Local Government Units (LGUs)

The data in this section present the status of the local government sector in recent years with particular consideration to liabilities and investments. The indebtedness of local government units, that is, municipalities (*gmina*), counties (*powiat*), county-status cities, and provinces (voivodships) is presented in Table 2, below (Main Statistical Office 2008).

Table 4.2
Total Local Government Debt (PLN million)

Year	Total
2003	17,277
2004	19,105
2005	21,181
2006	24,949
2007	25,876
2008	33,897

Source: Ministry of Finance 2009.

In 2008, the total amount of liabilities of LGUs had increased 31 percent since 2007 and 36 percent since 2006.

2.2 Public Investment

Public sector investment in Poland continues to grow at a dramatic pace. In the 2003–2008 period, the total investment outlays of the Polish public sector increased (see Table 3).

The increasing financial obligations of the public sector, coupled with regulations and restrictions on public debt (total debt is limited to 55 percent of budget revenues and total debt service is limited to 15 percent of budget revenues), reduce local governments' creditworthiness and thus its ability to use debt instruments (such as loans and bonds) for financing. In Poland, EU structural funds may help (presently available for the budget period of 2007–2013).

Table 4.3
Public Sector Investment (PLN million)

Year	Total
2003	35,197
2004	38,433
2005	45,679
2006	52,392
2007	61,415
2008	74,961

Source: Main Statistical Office 2009.

But, when used to finance municipal investments, structural funds require a local contribution as part of co-financing. Moreover, if an investment project is co-financed from structural funds, in principle it is financed up-front by local governments, which are later reimbursed (usually upon completion of the project). This requires that a local government, as investor, have funds available even before a project is initiated. Thus, while large (structural) funds are available, local governments may not have adequate creditworthiness or available funds to implement them. These circumstances mean that the financing for this “own contribution” may be lacking, which in turn makes it impossible to obtain structural funds for infrastructure development projects in Polish municipalities (Ministry of Economy 2007).

2.3 Beginnings of PPP

The first investments involving private capital in Poland were completed in the 1990s. In 1994, the Public Procurement Act came into effect, under which “public entities” contracted construction works and services provided by private parties (entrepreneurs). The act did not include any provisions on concessions and did not fully comply with EU regulations on public procurement. After Poland’s accession to the EU in 2004, the Public Procurement Act was replaced by another law on public procurement—the Law on Public Procurement, which has been amended several times in order to comply with EU regulations. The relevant provisions of this law are discussed below. Contracting public services (“service contracts”) as a form of PPP is popular in Poland, while infrastructure operations and maintenance contracts are less common and usually accompany other PPP forms, for example, municipal infrastructure lease agreements and new entities held jointly by public and private sectors (companies with “mixed capital”).

Until 2005 (when the first version of the Public-private Partnership Law came into effect) there had been no specific regulations on the public-private partnership formula. Despite this, several major, PPP-type projects were completed in Poland (apart from the very common public contracts) based on provisions in the Civil Code and the Public Procurement Law with respect to the selection of contractors. The general conclusion for Poland, however, is that the low number of investments carried out under PPP suggests that it is not a popular method of public services delivery.

3. CURRENT PUBLIC-PRIVATE PARTNERSHIP LAW IN POLAND

3.1 Legislation Directly Referring to PPP

In general, the PPP regulations in Poland can be divided into two groups: legislation *directly* referring to PPP and legislation *indirectly* related to PPP. Those directly referring to PPP are the following:

- **The Law on Public-private Partnership** was introduced on December 19, 2008 and came into force in February 2009.
- **Executive resolutions** (implementing legislation)
 - Resolution of the Minister of Economy of June 9, 2006 on the scope, forms, and principles of preparing information on PPP contracts (*Journal of Laws* July 13, 2006)
 - Resolution of the Minister of Finance of June 30, 2006 on the required elements of an analysis of a PPP project (*Journal of Laws* July 13, 2006)
 - Resolution of the Minister of Economy of June 21, 2006 on the risks related to implementing projects under PPP (*Journal of Laws* July 13, 2006).

3.2 Legislation Indirectly Related to PPP

Such regulations play a complementary role to the Law on PPP. As of August 2008, these included:

- **The Public Procurement Law of January 29, 2004** (*Journal of Laws* No. 19, item 177, as amended) in the scope that it affects the process of selecting partners and concluding PPP contracts.
- **The Law on Concessions for Works or Services.**

- **The Public System Law** in the scope that refers to authorizing public institutions to conclude PPP contracts and set up legal and policy acts that also have an impact on the criteria for selection of a private partner and final contents of PPP contracts.
- **The Budgetary Law**, which defines the total maximum amount of financial obligations due to PPPs up to which government bodies are allowed to incur (public debt).
- **The Civil Code**—since the Polish legislature placed the entire PPP system in the domestic civil law system, regulations of this act have a key importance for the development and performance of obligations of the parties under the PPP contract. The new Law on PPP uses the Civil Code as its main point of regulatory reference.
- **The Commercial Companies Code** in the scope necessary for creating a framework for “mixed capital companies” (project companies) set up in order to implement PPP contracts.
- **Specific sectoral regulations** referring to individual public tasks completed under PPP.
- **Documents of the European Commission** referring to PPPs.

4. THE POLISH PUBLIC-PRIVATE PARTNERSHIP LAW OF 2009

This section discusses the main components of the Polish Law on PPP of 2009. The law was passed in order to address the significant shortcomings of the previous law. The previous law, long overdue and essentially toothless due to a lack of implementing legislation for a significant period, was highly criticized for requiring huge outlays for studies and other preparatory works. As a result, no PPPs were registered under the rules of the previous law. While some PPP activity did take place—in particular, in the provision of municipal services such as water supply, solid waste collection, and recreation—examples were very few and were done outside the PPP structure and thus unregistered. One of the motivations for PPPs evident in other countries—public debt limits—has not been evident in Poland.

4.1 General Provisions

The Law on Public-private Partnership was introduced on December 19, 2008 and came into force in February 2009. The law is intended to serve as “the foundation

for a new era of development in Poland,” help to de-monopolize operations of public administration by enabling commercial entities to take over certain public tasks, and enable more efficient operation of public administration by providing better quality services to citizens at a lower cost to the government.

The new law sets out five principles, namely:

1. freedom of partnership between public and private entities;
2. protection of important public interests;
3. protection of justified private interests;
4. protection of public debt;
5. compliance with EU law.

The new law contains much less detail than the previous version and is designed to provide only a framework, avoid creation of unnecessary provisions, and apply only proven legal solutions contained, *inter alia*, in commercial and civil law. It has also been designed to provide as much space as possible for both parties to craft approaches, particularly concerning contracts, that meet their needs.

4.1.1 What Is a PPP?

The law defines a PPP as “joint completion of an undertaking based on division of tasks and risks between the public entity and private partner” (Article 1[2], 2[4]). The definition of an undertaking is very broad, as it is based on concepts set out in civil law. The law does not limit the scope of PPPs to investment tasks, but accepts any public task as an eligible PPP, provided that public interest is shown to benefit. Parties to the PPP enjoy freedom of contract based on binding law in Poland as well as to good practices and procedural models.

4.1.2 Participants of PPP

Under the Law on PPP, a public entity is that which is required to use the Public Procurement Law (Article 2[1], 2[2]). Because the list of contracting authorities also includes categories of private partners that are required to apply public procurement regulations, the catalogue of “public entities” is narrower and covers only these categories that definitely belong to the public sphere. Accordingly, under the Law on PPP, **public entities** are:

- public finance sector units, as provided under public finance regulations;
- other state organizational units without status of a legal person;
- other legal persons established for the specific purpose of meeting public non-industrial and non-commercial needs, if public entities:
 - provide more than 50 percent of financing, or
 - hold more than a half of shares, or
 - supervise their managing bodies, or
 - have the right to appoint over a half of their supervising or managing bodies; or
 - associations of the aforementioned entities.

Private partners include entrepreneurs, including foreign ones, defined by the Law on the Freedom of Business Activity. The Law on PPP requires only that a private partner be authorized to conduct business activity in Poland.

4.1.3 Own Contributions, Undertakings, and Assets

A **public entity** or **private partner** makes an own contribution by:

- incurring a portion of expenditures on an undertaking, including financing a supplement to services provided by the private partner under the project;
- contributing an asset (Article 2[3], 2[4], 2[5]).

The law makes extensive use of civil law concepts and defines an **undertaking** very broadly as one or more of the following activities associated with operating, maintaining, or managing an asset that is the subject of or related to:

- constructing a building;
- providing services;
- performing work, particularly furnishing an asset with equipment that enhances its value or utility;
- other services or contributions not mentioned above.

In defining an **asset**, the Law on PPP uses terminology from Civil Law. The broad definition of an “asset” makes it easier to adjust the duties of the PPP contract parties to concrete situations. Assets that can serve as an own contribution in a PPP include real estate, enterprises, buildings and structures, other permanent facilities, chattel, and property rights.

4.1.4 Selection and remuneration of a private partner

If remuneration of a private partner comes exclusively from a public entity, the private partner should be selected based on the Public Procurement Law (Article 4, 5, and 10). The law identifies competitive dialogue as the most appropriate selection procedure. If, however, remuneration of a private partner stems from the right to derive benefits from the partnership or this right and payment of a defined amount of money, the private partner should be selected based on the Law on Concessions of December 9, 2009, with consideration toward the provisions of the Law on PPP.

If the PPP contract is terminated before the expiration of its term, the public entity either selects another private partner or completes the undertaking in a manner other than PPP.

4.2 Value for Money

“Value for money” is defined as the total of the criteria used to select the best offer (Article 6). Because in the case of a PPP price cannot be the sole selection criterion, the law sets out a list of criteria (both mandatory and optional) to be used to select the best offer.

- **Mandatory criteria:**
 - distribution of tasks and risks between the private partner and public entity;
 - deadlines for completion and amounts of payments or other benefits from the public entity (if planned).
- **Optional (in particular) criteria:**
 - distribution of profits between the public entity and private partner;
 - ratio of the public entity’s own contribution to the private partner’s own contribution;
 - effectiveness of project completion, including the effectiveness of use of assets;
 - quality, functionality, technical parameters, proposed technology level, maintenance costs, service.

4.3 Umbrella PPP Agreement

The PPP contract is an umbrella agreement (Articles 7 and 13). It is based on a:

- **private partner** undertakes the obligation to complete the project in exchange for payment and fully or partially to incur outlays for its completion or to cause a third party to incur the project expenses;

- **public entity** makes an obligation to cooperate in order to achieve the objective of the undertaking by, in particular, making an in-kind contribution;
- **each party** incurs a portion of the project's risk.

The remuneration of the private partner depends on the actual utilization or accessibility of the object of the PPP.

Individual obligations under a PPP contract can be expressed in forms allowed under the existing provisions of the Civil Code. The law interferes little in the contents of a PPP contract, stipulating that the contract should define the consequences of non- or incomplete performance of an obligation, in particular, contractual fees or a reduction of the private partner's (or project company's) remuneration.

The law prohibits changing the contents of the PPP contract in relation to the contents of the proposal, based on which a private partner was selected, except for circumstances that could not have been foreseen at the moment of concluding the contract.

4.3.1 Own Contributions of Parties

Own contributions of the parties in the form of assets can be made as sales, lending, right of use, rent, or lease (Article 9). If the asset contributed by the public entity is utilized by the private partner in a manner that obviously contradicts its purpose set out in the PPP contract, the private partner (or a project company) is obligated to return the asset to the public entity based on the provisions defined in the PPP contract (or in the company articles).

4.3.2 Project Control

Because the purpose of a partnership usually is to perform public tasks, as an exception to the freedom of contract, the new Law on PPP assigns the ongoing right of control to the public entity (Article 8). This deviation is meant to ensure that a standard of project performance is maintained, particularly concerning public facilities and tasks. The detailed procedures for control should be defined in the PPP contract.

4.3.3 Transfer of Assets upon Termination of Agreement

The law provides that upon the completion of a partnership, the "asset" that was used should be returned to the public entity, unless otherwise stipulated in the PPP contract

(Articles 11 and 12). The asset should be in an undiminished condition, except for wear and tear from proper use. The contract may also provide that the asset should be returned to a state or local government legal entity other than the one involved in the project or to a company set up by the public entity in order to implement the project. The private partner will have—both during the binding period of the PPP contract and directly after completion of the partnership—the right of preemption concerning the property (real estate) that constituted the public entity’s own contribution to the partnership, in the event of its sale.

4.4 Flexible Forms of PPP

PPPs can be based on a PPP contract itself, or a special “project company” can be established in order to complete the project, the purpose and objectives of which are defined by the parties to the PPP contract (Articles 14, 15, and 16). Thus, the Law on PPP leaves no doubt as to whether project companies constitute PPPs and devotes an entire chapter to project companies. Provisions concerning a project company are generally based on provisions from the Code of Commercial Companies with modifications aimed at the protection of public entities.

4.5 Risks Associated with PPP Undertakings

According to the Law on PPP, the partnership is based on a division of tasks and risks between the public entity and private partner. The law does not specify the risks and categories of risks, but simply underscores the fact that the partners should jointly carry out the undertaking and share the incumbent risks. Thus, the provisions on risk only provide a guide, without any specific regulations defining the position of partners or the contract itself connected with this definition.

4.6 Financing PPP from the State Budget

The Law on PPP provides that the total amount of financial obligations made by public entities due to concluding PPP contracts in a given year should be defined in the state Budget Law (Articles 17 and 18). The law introduces the requirement on obtaining consent of the Minister of Finance on contracts exceeding PLN 100 million (about EUR 24 million). Additionally, the Minister of Finance must consider the public finances and public debt in issuing a permit. The period for review of the request for consent is set as six weeks.

4.7 PPP and EU Funds

The Law on Rules for Implementing Development policy was amended by adding a provision that clearly permits co-financing of PPP projects using EU funds, which is meant to remove any doubts as to whether such financing is possible for projects implemented under the PPP formula.

4.8 Competitive Dialogue Procedure to Select a Private Partner

The competitive dialogue procedure was introduced with the Public Procurement Law in 2007. Under this procedure, upon prior publication of a contract notice, the contracting authority conducts a dialogue with selected contractors and then invites them to submit bids. The contracting authority may award a contract under competitive dialogue if the following conditions are met:

- Award of the public contracts under open or restricted tender procedures is not possible. Due to the complexity of the contract, the subject matter of the contract cannot be described in accordance with the Public Procurement Law requirements, or it is impossible to define the legal or financial conditions for performance of the contract.
- Price is not the only criterion for selecting the winning bid.

If the value of a works contract exceeds the equivalent (in PLN) of EUR 20 million, and for supplies or services in excess of EUR 10 million, the application of the competitive dialogue tender procedures requires prior consent of the president of the Public Procurement Office in the form of an administrative decision.

Contractors submit their applications for participation in the procedure and are then qualified to enter the next stage of negotiations. The contracting authority immediately informs those contractors that meet the procedural conditions and invites them to a dialogue. If the number of contractors that meet the criteria for participation in the procedure is higher than the number defined in the notice, the contracting authority invites only those contractors that received the highest evaluation. The contracting authority conducts the dialogue until it is able to define the solution or solutions that meet its needs.

After declaring the dialogue completed and informing the participants of this fact, the contracting authority invites the participants to submit final tenders, based on the solution/solutions agreed during the dialogue. These tenders should contain all the requested elements necessary for execution of the project. Final tenders are evaluated by the contracting authority based on the criteria for the award of public contracts defined in the tender notice.

It is important to note, however, that the new Law on PPP defines a tender differently than the Public Procurement Law. According to the Law on PPP, the best bid is that which offers the most favorable relationship between the remuneration and other criteria relevant to the undertaking, including distribution of tasks and risks between the public and private partner as well as deadlines and remuneration or other benefits.

5. PUBLIC WORKS CONCESSIONS

5.1 Concessions in EU Legislation

Community law provides for the possibility of entrusting other parties with performance of public tasks based on concessions. Definitions of concessions are contained in Directive 2004/18/EC of the European Parliament and of the Council of Europe of March 31, 2004 on the coordination of procedures for the award of public works contracts, public supply contracts, and public service contracts. In the case of public works contracts, Directive 2004/18/EC regulates in detail the procedure binding the contracting authority, aimed at selecting the contractor with whom the contract will be concluded. The provisions related to public works concessions are general and limited. First of all, Directive 2004/18/EC applies only to those public work concessions where the value of the contracts is equal to or greater than EUR 5.15 million (the value changes and is calculated in accordance with the rules applicable to public works contracts in Article 9 of the Directive).¹

In the case of the award of public works concessions, the contracting authorities are obligated to apply regulations of Directive 2004/18/EC relating in particular to the obligation of publishing notices in the *Official Journal* of the EU, and to define an appropriate time limit for the receipt of requests to participate. Directive 2004/18/EC does not regulate the concession procedure, leaving it to the discretion of member states. Selection of the concessionaire can be made under the procedures listed in Directive 2004/18/EC (open, restricted, competitive dialogue, or negotiated procedure with prior publication of a contract notice), or any other method provided in national legislation. The Directive requires only that the minimum time limit for the receipt of requests to participate be kept. This means that in contrast to the rigorous procedures for the award of public contracts set out in Directive 2004/18/EC, EU member states enjoy considerable freedom in developing domestic regulations on the award of concessions.

Polish legislation has implemented these rules into its Public Procurement Law. Under Polish law, the works concession is, in fact, a form of performing a task using mechanisms typical of a public-private partnership.

5.2 Concessions in Polish Law

A public works concession is, in fact, a works contract that differs from the contract in that the remuneration of the concessionaire exists either solely in the right to operate the work (the constructed facility) or in this right together with payment. The award of a concession is not an administrative act and does not constitute privatization of public tasks. Public entities continue to be responsible for their execution. Concession is a method of carrying out public tasks in which the majority of the economic risk of successful execution of an undertaking is transferred onto the private party, in contrast to public works contracts, in which the entire economic risk of the successful completion of a project is borne by the contracting authorities. Concessions are applied in those cases where the beneficiaries are third parties, that is, actual users of the effects of the concession, and not the contracting authority.

The concession regulated in the Public Procurement Law, in contrast to other available forms of performing public tasks, may be applied exclusively to construction works. The Law on Public Works and Services Concessions standardizes the procedures in reference to both works and services.

Similarly as in the case of the public-private partnership, the concession can be awarded with the relevant application of the regulations on open procedure, restricted procedure, or negotiations with prior publication of a contract notice. The contracting authority and the entity awarding the works concession can be, *inter alia*, the public finance sector bodies, such as municipal, county, and provincial local governments, as well as their associations, budgetary units, and budgetary enterprises.

In selecting the best tenders, apart from the criteria defined in a terms of reference, the contracting authority is also allowed to take into consideration subjective criteria meant to evaluate contractors specifically, such as their technical, economic, and financial capabilities. This is the basic difference between the procedures defined in the Public-private Partnership Law that precludes the application of such criteria in the selection of a private partner. The solution used for concessions obviously facilitates and makes the selection of the right partner more flexible.

As in the case of performing a task based on the Public-private Partnership Law, the remuneration for a contractor holding a works concession consists either solely of the right to exploit the work (constructed facility) or this right together with payment.² The concession contract should cover a period of time sufficient for the contractor to recover investment costs. Polish regulations do not require the consent of the president of the Public Procurement Office to enter into such a contract for a period longer than three years; the contract, however, should be concluded within a defined period of time.

Moreover, the concession contract can be concluded for more than three years without meeting the conditions provided in this regard by the Public-private Partnership Law, that is, without conducting a relevance analysis with a consideration of the scope

of planned outlays and their payback period, the payment capacity of the contracting party, and the evaluation as to whether implementation of the contract in the applied period of time will result in savings of the project costs compared to the three-year period.

If the value of a concession is less than the PLN equivalent of EUR 5.15 million, the contracting authority is obligated to publish a notice in the *Public Procurement Bulletin*. If the value is equal to or higher than this amount, the contracting authority must publish a notice in the *Official Journal* of the European Communities. In summary, it can be concluded that in certain situations, the public works concession can be a simpler and more effective form of carrying out a project in public-private partnership.

Attention, however, should be drawn to the confusion concerning concessions, and particularly to the number of laws that refer to concessions. In Poland, particular sources of confusion include the Toll Highway Law, which duplicates many regulations of public procurement law. At the same time, the government passed the Law on Public Works and Public Services Concessions (Law on Concessions), which replaces the concession provisions in the Public Procurement Law.

Despite the fact that the regulations on public work concessions (Polish regulations refer to them specifically as “construction works”) in the Public Procurement Law have been in force since 2004, the Polish market for these concessions remains very small. So far, the only example of an investment completed under the work concession model is an underground parking lot in Krakow (described later). The analysis of the market for PPPs, however, shows an increase in interest for this kind of PPP (see also the section on the market for PPPs). Since 2007, there have been 18 tender procedures for concessionaires of public investments published.

One reason for this is the fact that the procedure for awarding works concessions provided in the Public Procurement Law is very similar to the rigorous procedures for awarding public contracts. In addition, Polish law does not provide for the possibility of awarding public service concessions. The new law is intended to unblock the system of works concessions and create a new institution—the public service concession. The new law contains more flexible regulations covering both institutions in a comprehensive manner. The law replaces chapter 4 of the Law on Public Works Concessions and functions next to the new Law on PPP.

6. PUBLIC-PRIVATE PARTNERSHIP PROJECTS IN POLAND

Despite the fact that a Law on PPP has existed in one form or another in Poland for some years, cooperation between private and public partners has developed despite this legislation instead of due to it.

The main forms of cooperation between the public and private partners in the public utility sector are as follows:

1. creation of public utilities with mixed capital—mainly in the water and waste-water sector (project companies or special purpose vehicles);
2. contracting public utility services is a very common practice (on the basis of the Public Procurement Law);
3. BOT-type investments;
4. (construction) works concessions (based on the Public Procurement Law), covering mainly municipal investments (in Poland also in the BOT system).

PPPs are likely to be found in mixed capital companies. While the number of such companies is significant in Poland, the total comprises just a small percentage of units carrying out public tasks. Information on such companies is collected and published by the Ministry of the Treasury in the annual document entitled *Information on Transformation and Privatization of Communal Property*, issued based on Article 69 of the Commercialization and Privatization Law of 1996 (as amended). The last issue describes the status as of December 31, 2005. The report presents data collected from 94.6 percent of local government units.

The data collected by the ministry enable the monitoring of organizational, structural, and ownership transformations (privatizations) in the entire public sector of the national economy. The report describes organizational and legal forms of public utilities. The following table presents these entities by economic sector and types of operation. From the table, it follows that mixed capital companies, limited liability, and joint stock companies, account for 477 (11 percent) and 151 (12 percent) of total public entities.

Given that the vast majority of PPPs in Poland are in the water and wastewater sector, however, mixed capital companies are not a guarantee that a given approach constitutes a PPP.

Contracting services are the most common method of cooperation between the private and public sectors. The selected services are commissioned to private entities, usually selected in accordance with the Public Procurement Law for a period of several years.

The assessment of the number of public utility contracts is difficult due to commonness of such practices and lack of any official reports or studies prepared by relevant institutions, such as the Main Statistical Office. Thus, the sources of information on PPP include reports and publications of individual municipality or other interested organizations, such as law offices.

Table 4.4
Public Utilities by Organizational and Legal Forms (as of the end of 2005)

Specification	Total	Budgetary establish- ments	Budgetary units	Budgetary entities	Limited liability companies			Joint stock companies (S.A.)		
					1*	2*	3*	1*	2*	3*
Public transportation	176	2	5	34	89	13	24	2	-	7
Water and wastewater	603	8	20	269	232	33	29	8	1	3
Supply and production of heat and electricity	272	1	—	20	158	7	70	5	—	11
Waste disposal	234	3	13	68	80	13	50	3	—	4
Municipal and roadside greenery	340	4	276	21	24	1	13	—	1	—
Municipal housing mgmt.	676	9	33	266	277	20	66	1	—	4
Other public utility services	711	7	230	189	79	13	95	7	8	83
Multibranch public utility entities	663	8	25	315	227	20	66	—	—	2
Social services	410	—	299	63	25	3	15	2	1	2
Non-public utility entities	135	2	1	2	40	5	49	1	—	35
Total	4,173	44	902	1,247	1,231	128	477	29	11	151

Source: Ministry of the Treasury (2006).

Notes: * 1—one-shareholder companies (Ltd., S.A.)

2—companies owned by more than one local government (Ltd., S.A.)

3—mixed-capital (private and public) companies (Ltd., S.A.)

In addition, due to Polish regulations, elements that would be found in operating contracts for the water and sewerage sector in other countries are included in a number of documents required by law, such as:

- permits;
- service regulations for providing water and collecting wastewater;
- multiyear investment plan;
- ordinance of the minister of construction on setting tariffs.

For this reason, most municipalities and water and sewerage utilities do not prepare additional operating contracts, as they consider the foregoing documents to be sufficient to govern the relationship. Only the privatization of services necessitates a more precise definition of elements not governed in the aforementioned documents.

6.1 Water and Wastewater Sector

6.1.1 Establishment of the Water and Wastewater Management Company in Gdańsk

This venture is considered the first project in Poland, and possibly in all of Central and Eastern Europe, implemented under PPP. This case combines a few PPP models: service contract, operation and maintenance contract, leasing and privatization. It involves establishing a company with mixed—private and public—capital, in effect a project company.

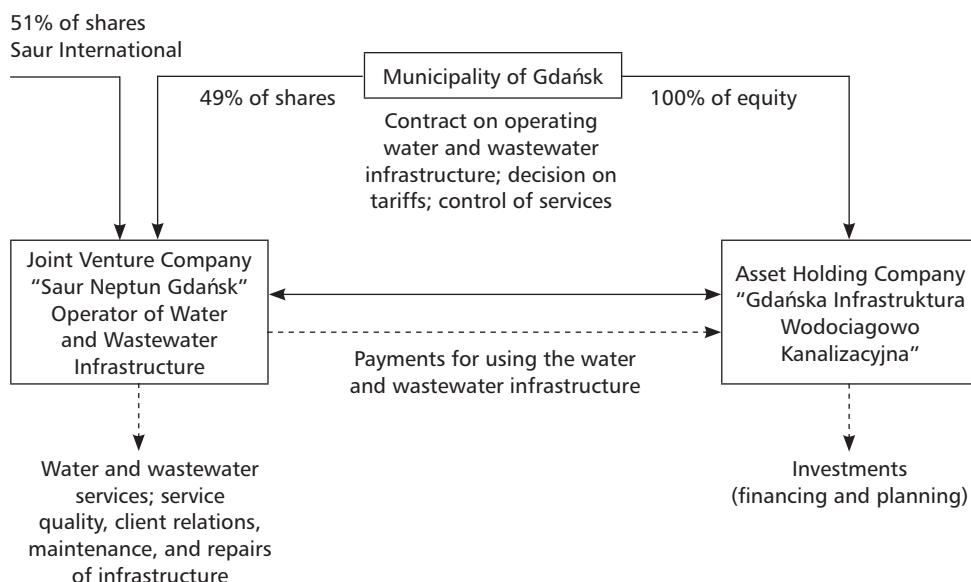
Table 4.5
Summary of Saur Neptun Gdańsk S.A.

Name of the project	Saur Neptun Gdańsk S.A. (Joint Stock Company)—SNG
Purpose of the undertaking	Provision of water and wastewater services for residents of Gdańsk, Sopot, and neighboring municipalities
Selection of the private partner	Negotiations between the parties
Participants	The city of Gdańsk and Saur—an international public utility group
Organizational and legal PPP model	Service contract, operation and maintenance contract, leasing of infrastructure
Sector of the economy	Water and wastewater management
Year of contract conclusion	1992
Financing	The public entity finances investment—100 percent, the private partner pays a leasing fee and operates the infrastructure by providing water supply and wastewater disposal services based on agreements with the municipalities of Gdańsk and Sopot.
Model of cooperation	Establishment of the mixed capital company: 51 percent—Saur and 49 percent—the city of Gdańsk

Management structure/ cooperation principles	<p>The contract on operating the water network and waterworks equipment, and wastewater network, including wastewater pumping stations and water intake stations was concluded for 30 years.</p> <p>The public sector is responsible for investments in the storm water system, while the private partner is responsible for operations of the wastewater system, coordination of the investments (pays the leasing fee). User fees collected from residents comprise two components: operating fee (for SNG) and fixed fee (lease)—paid to the city budget and designated for asset rehabilitation. After an amendment to the contract in 2005, the fixed fee is paid to a new, municipally-owned company Gdańska Infrastruktura Wodociagowo-Kanalizacyjna (GIWK) (Gdańsk Water and Wastewater Network Infrastructure). GIWK took over the infrastructure and the responsibility for investment planning and financing. The city makes decisions on tariffs and controls the services provided by SNG; while SNG leases the infrastructure from the city, is responsible for the quality of services, customer relations, as well as maintenance and repair of the infrastructure.</p>
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Source: SNG 2009.

Figure 4.1
Cooperation Schedule— Saur Neptun Gdańsk S.A.



Source: SNG 2009.

The agreement between Gdańsk and Saur Neptun was signed in 1992. It was the first PPP in water supply and sewer services in Poland. Gdańsk retains ownership of infrastructure (and is responsible for capital investments), while Saur Neptun is the operator and is responsible for coordinating the investment process (French PPP model). Shares in Saur Neptun belong to Saur (51 percent) and the city of Gdańsk (49 percent). Currently, Saur Neptun provides services for a half million inhabitants from Gdańsk (and the nearby city of Sopot). Tariffs comprise two parts: an operating fee (for Saur Neptun) and a fee for modernization and capital investments (transferred to the municipal budget). The contract was signed for 30 years.

6.1.2 Aqua–Bielsko-Biała—First Water and Wastewater Joint Stock Company

In the Bielsko-Biała, the water and wastewater services are provided by AQUA S.A. The origins of the company are related to privatization and ownership transformation. The firm is the first water and wastewater company in Poland to be transformed into a joint stock company. Provision of public utility services is based on the management, operations and maintenance contracts and leasing agreement.

Table 4.6
Summary of Aqua S.A.

Name of the project	AQUA S.A.
Purpose of the undertaking	The water and wastewater management in Bielsko-Biała and 14 other municipalities of the Podbeskidzie region. The main activity of Aqua S.A. is the provision of water and wastewater services. They include: operating of water and wastewater facilities and installations, water intake, treatment and supply to the residents of the following municipalities: Bielsko-Biała, Szczyrk, Kęty, Wilamowice, and communes: Buczkowice, Jasienica, Jaworze, Kozy, Porąbka, Wilkowice, Andrychów, Bestwina, Chybie, Czechowice-Dziedzice. The company provides also bulk water supply to the following municipalities: Andrychów, Czechowice-Dziedzice, Kęty, and Bestwina. Moreover, Aqua S.A. collects and treats wastewater from Bielsko-Biała, Szczyrk, Buczkowice, Wilkowice, Jasienica, and Jaworze.
Selection of the private partner	Privatization, ownership transformation
Participants	The city of Bielsko-Biała, other municipalities of the Podbeskidzie region

Organizational and legal PPP model	Contracts on services, management, operations and maintenance, privatization
Sector of the economy	Water and wastewater management
Year of contract conclusion	1990—beginning of ownership transformations
Financing	Investments in the infrastructure are financed only from Aqua S.A.'s means, while the city of Bielsko-Biała invests only by purchasing stock issues.
Model of cooperation	Joint stock company with the following ownership structure: Bielsko-Biała Municipality—51.06 percent, United Utilities Poland B.V.—33.18 percent. The remaining stock (15.06 percent) is owned by the municipalities of the Podbeskidzie region and private investors. The stock capital as of end of 2005 amounted to about PLN 207 million and was divided into about 12.9 million shares.
Management structure/ cooperation principles	<p>Aqua S.A. provides water and wastewater services concerning, in particular, water treatment and supply in the area of 14 municipalities of the Podbeskidzie region, and wastewater collection and treatment in six municipalities. Presently, the total population served amounts to nearly a quarter million residents. While the main users are households, residential co-operatives, the number of public institutions and service and production businesses is significant as well.</p> <p>For its water operations, the company operates water intakes, water treatment stations, and networks. For its wastewater operations, the company uses wastewater networks and wastewater treatment plants. Aqua operates the infrastructure based on the leasing contract. The infrastructure is owned by the municipalities.</p>

The responsibilities for water supply, wastewater treatment, and storm water collection are carried out by the joint stock company Aqua. The company operates in Bielsko-Biała (176,000 inhabitants) and nearby municipalities. Altogether, the company provides services for 225,000 inhabitants. The sewer system operated by Aqua comprises 134 kilometers of combined sewers and 70 kilometers of storm sewers. Combined sewers are located mostly in the old city center and are successively replaced with separate systems. Aqua is the owner of the infrastructure as well as the operator (British PPP model). In 1999, International Water UU Holdings B.V. (currently United Utilities (Poland) B.V.) purchased shares in Aqua. The ownership structure is as follows: municipality of Bielsko-Biała (51 percent), United Utilities (Poland) B.V. (33 percent), and other shareholders (16 percent) (Aqua 2009).

6.2 Modernization of Street Lighting in Kraków (BOT)

A BOT-type of PPP, this project involved an investment project for the modernization of street lighting of the city of Kraków under the ESCO formula with third-party financing. A similar investment project was also implemented in the city of Bytom.

Table 4.7
Summary of Krakow Street Lighting BOT

Name of the project	Modernization of street lighting in Kraków
Purpose of the undertaking	Modernization of city lighting (excluding the downtown area, which is subject to conservation laws). The following tasks were completed under the project: replacement of lighting fittings, light sources and (to a limited extent) replacement and renovation of the remaining elements of the installation (control panels and lighting poles).
Selection of the private partner	In accordance with the Public Procurement Law
Participants	City of Kraków, consortium of the companies: Elektrim—ES System Krakow
Organizational and legal model	BOT
Sector of the economy	Municipal infrastructure—lighting
Year of contract conclusion	1998
Financing	The private partner—100 percent of the investment costs
Model of cooperation	Completion, operations, and maintenance contract
Value of the contract	PLN 12.9 million—the base sum of annual payments set aside in the city budget for a period of six years (valorized annually)
Management structure/ cooperation principles	<p>The contractor of the investment—the consortium Elektrim Warszawa—ES System Kraków financed and completed all works concerning modernization of the lighting system.</p> <p>Upon completion of the modernization works, the consortium operated the entire lighting system for six years, which enabled it to recover its investment costs from the generated savings. The institution responsible for the management of the lighting system is the Roads and Transportation Management Company (a municipal unit). The contractor received the difference between the valorized base amount (secured in the municipal budget) and the actual bills for electricity, presented by the Roads and Transportation Management Company. Thus, the contractor's objective was to generate maximum possible energy savings and to reduce operating costs.</p> <p>The result of the project was a significant improvement of the street lighting in Kraków. As reported by the municipality, the operational reliability of the installation increased, the use of energy was reduced, and the general safety of traffic and movement increased.</p>

6.3 Underground Parking in Krakow—Concession (DBFO)

The investment project is executed under a works concession. The contractor and the operator of the parking lot is a Spanish company—ASCAN Empresa Constructora y de Gestion S.A., selected under a tender. Thus, it is an example of DBFO model of PPP. In this particular case, the remuneration of the concessionaire is the right to use the facility and draw relevant profits. The city of Kraków, based on its positive experience, plans completion of other municipal investment projects based on awarded works concessions. They include another three parking lots.

In Poland, the market for such contracts has been developing since 2007. According to the document “Information on the Polish Public Contracts Market,” the study prepared by the Department of Computerization and System Analyses of the Public Procurement Office, there were five published notices of this type of contract in Poland in 2007 and thirteen in 2008 (up to July 31) (PPO 2009). The popularity of this form of cooperation appears to be increasing.

Table 4.8
Summary of Krakow Underground Parking Lot DBFO

Name of the project	Underground parking lot—“Na Groblach” Square in Kraków
Purpose of the undertaking	Construction of the underground parking lot (for 600 spots); pulling down and reconstruction of the School Sports Center facilities and sport fields.
Private partner selection	According to the Public Procurement Law
Participants	The city of Kraków, Ascan Empresa Constructora y de Gestion S.A.
Organizational and formal model	DBFO
Economy sector	Municipal infrastructure—parking lots
Year of the contract signing	2006
Financing	The private partner covered 100 percent of investment costs
Model of cooperation	Works concession
Value of the investment	PLN 62.7 million
Management structure/ cooperation rules	The entire cost of investment is covered by the Spanish company, which in exchange was granted the right to charge parking fees for a period of 70 years. Additionally, the contractor pays the property tax and is obligated to renovate all of the streets and pavements around the square. The company is experienced in constructing similar facilities in historic urban areas.

7. MARKET POTENTIAL FOR PPP

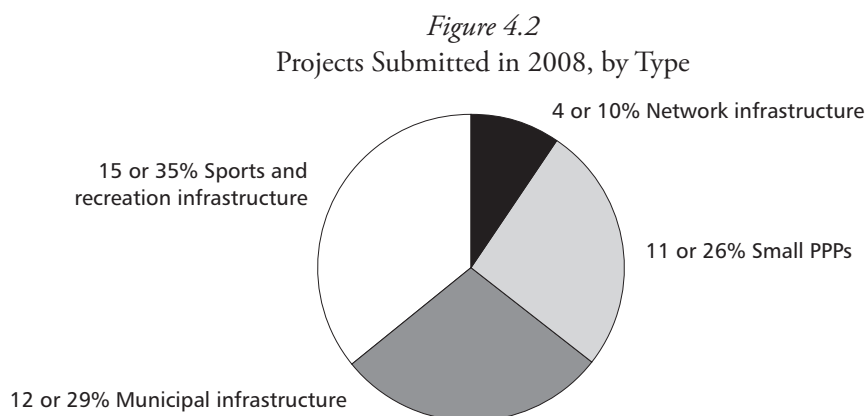
In 2007 and 2008, two editions of a competition for the best PPP project were conducted in Poland (Investment Support 2009). The competitions were organized by the company Investment Support and the Ministry of the Economy under the patronage of the Public Procurement Office with the participation of private partners such as Lewiatan (a leading organization of Polish employers), a few large banks, and a Polish daily—*Rzeczpospolita* [Res Publica]. The rank of these competitions, and in particular the participation of the Ministry of the Economy, provides some insight into the market potential for PPP in Poland.

PPP projects (submitted in both 2007 and 2008 editions) can be divided into four categories:

- **municipal infrastructure** (municipal construction, revitalization programs, modernization and construction of public facilities);
- **network infrastructure** (projects in transportation, water and wastewater, and energy sectors);
- **sports and recreation infrastructure** (among others, sports and recreation centers, stadiums, sports and event halls);
- **small PPPs** (projects valued at less than EUR 10 million, regardless of the sector).

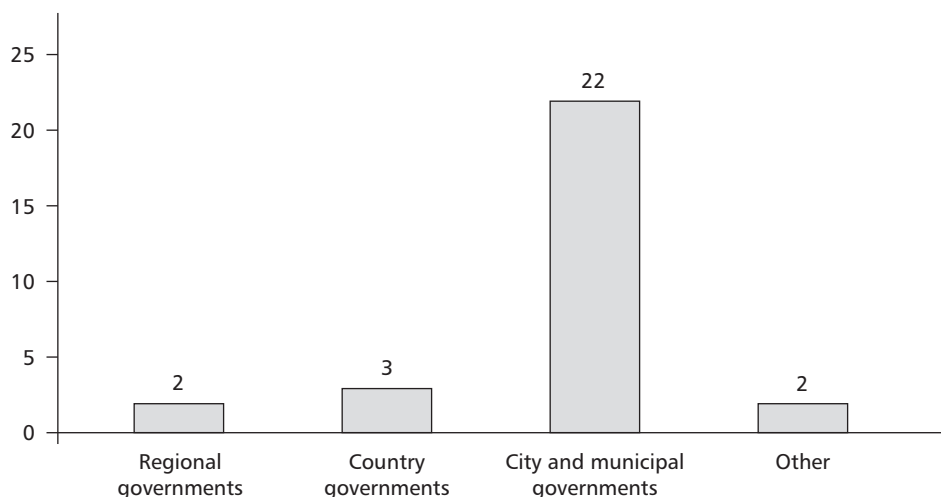
7.1 2008 Edition of Best PPP

A total of 42 projects of investments proposals for implementation together with private partners were submitted for the competition. A Pilot PPP Project Program was implemented under this edition. The number of projects submitted by category is presented in Figure 4.2.



As in 2007, project proposals in the sports and recreation sector were once again most popular. These projects included construction of sports and event halls and various types of water parks. The municipal infrastructure category included both projects from the health protection sector as well as those concerning construction of parking lots and revitalization of neighborhoods. The network infrastructure category included four transportation projects submitted by local governments. The small PPPs involved extension of water mains, construction of the city hall, and modernization of road infrastructure. Most submissions came from cities and smaller municipalities, which together comprised a total of 22 projects (see Figure 4.3).

Figure 4.3
Local Government Types Submitting PPP Proposals in 2008



Geographically, most projects continued to be from the more developed regions of Poland, with a slight increase in projects from the poorer, eastern part of Poland, though still underrepresented.

8. BARRIERS TO THE DEVELOPMENT OF PPP IN POLAND

In summary, the main barriers to the development of PPP in Poland can be divided into two main groups: (i) lack of experience, which gives rise to mistrust and other psychological barriers, and (ii) legal barriers, due to the lack of a workable legal framework for PPPs.

8.1 Lack of Experience

According to some experts, lack of experience and fear of the unknown constitute the main barrier to PPP development in Poland.³ In Poland, political and social doubts remain as to whether private partners can be trusted with public administration tasks. One of the most common concerns is the possibility of corruption at the point of contact between private and public interests. Due to a lack of social consent, the need is acute for PPP regulations that will both dispel concerns and provide a framework for protection, particularly of local governments, from excessive project risk.

Local governments typically have no professional legal resources at their disposal and it is up to municipal employees to assess the risks and benefits of an investment project. Engaging consultants in the preparation of economic and legal studies is still not widely practiced in Polish local governments; consultants are used primarily to prepare applications for co-financing from EU funds and supporting documentation, as well as technical studies required by law.

The lack of experience in local government offices coupled with their mistrust of businesses mean that local governments are seldom the agents of change in PPP projects. But, businesses are also not currently planning pilot projects at the local government level. Businesses in Poland remain of the opinion that the financial responsibility for execution of such projects, especially for novel projects, should lay with government authorities. Thus, PPPs should be initiated by local governments since they best know the needs of their constituents.

Local governments' relatively low level of experience in cooperation with private partners results in a low interest in and initiative to undertake PPPs as a form of investment implementation. In order to disseminate and promote knowledge on PPPs, an initiative was created in October 2007 and the Public-private Partnership Center was established. An initiative of both private and public partners, the center is intended to be an independent civic institution organized by those organizations with the most needs. The main stakeholder is the Polish Confederation of Private Employers "Lewiatan," operating in cooperation with several institutions, including other employer organizations, consulting companies, banks, law firms, and local government organizations. The underlying idea is to create an institution similar to those operating in many other European countries, such as Great Britain, Germany, and the Czech Republic. The center began operations in the fall of 2008.

The objective of the PPP center is to facilitate implementation of PPPs in Poland by creating conditions that would shorten the time and costs of project preparation, as well as promoting the PPP concept. The center also intends to promote investments conducted jointly by public and private entities with an aim toward addressing the most urgent infrastructural needs such as roads and highways, railway networks, airports, local infrastructure, healthcare infrastructure, etc.

The center is also intended to remove obstacles to PPP investments by collecting and disseminating the experiences and best practices from countries with successful PPPs. The center focuses on serving as a clearinghouse for PPPs, preparing standard contracts and procedures, monitoring PPP investments, and proposing amendments to applicable regulations. In addition to member contributions, the central government has committed to support financially the center's initiatives and the European Investment Bank has declared a willingness to provide technical assistance.

8.2 Legal Barriers

The previous Law on PPP was criticized for:

- The need to prepare time and capital-intensive analysis before deciding on cooperation with a private partner. This obligation is particularly burdensome for minor projects and effectively removes the incentive for their implementation.
- Complicated initial procedures including the restrictive regulations concerning the selection of the private partner.
- Formal and legal barriers, for example, the need to publish a notice on the planned undertaking in the *Public Procurement Bulletin* and the *Public Information Bulletin*. The forms recommended for use in developing a PPP, however, do not contain relevant sections on publishing the intent to implement a PPP project. Yet, according to the law, the failure to publish such information renders the PPP contract invalid.
- Regulations safeguarding the interests of both parties in the contract are absent.
- Unnecessary bureaucratic obligations hampering cooperation between local governments and businesses.

Presently, it is not clear how and to what extent the contribution of a private partner in the PPP venture can be connected to the budget of an investment to be co-financed with EU funds. The new law regulates the manner of utilizing resources from structural funds in undertakings carried out under PPP.

Analysts contended that the old Law on PPP was completely unnecessary because there was no need for another document that changes a whole array of existing regulations. In response, the new Law on PPP was constructed as a framework document and all of the key terms should be included in contracts between the public authorities and private partners. The parties to an undertaking enjoy the greatest possible freedom concerning the details of cooperation, which should be placed in every contract. Experience from other countries shows that, when framework regulations are in place and psychological barriers are absent due to sufficient experience, PPPs develop very well.

9. FINAL RECOMMENDATIONS

Poland has apparently taken positive steps toward fostering development of public-private partnerships. First, the new Law on PPP replaces a law that, while in force for about three years, was effectively invalid due to the lack of any projects implemented under its provisions. The new law draws experience from other countries by replacing rigid and detailed procedures with framework guidelines. This will undoubtedly draw criticism from some proponents of local government, as it may be viewed as providing insufficient risk protection for local governments. In addition, while Poland has good examples of PPPs in the water and wastewater sector, these examples remain few and far between.

Second, psychological barriers stemming from a lack of experience are being addressed with the establishment of the Public-Private Partnership Center, which is intended to serve as a clearinghouse of information and best practices on PPPs, while at the same time providing technical and financial assistance in preparing studies on PPPs.

These two steps constitute recommendations for other countries, in particular CEE countries without a history of public and private cooperation and now developing PPPs.

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NOTES

- ¹ See both Articles 9 and 56 of the Directive.
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- ³ For example, Piotr Sołtyski, project manager of “Hochtief PPP Solutions” as cited in Jezierska (2008).

Public-private Partnerships in Serbia

Towards Policies That Provide Risk Sharing and Value-for-Money Investment

Tatijana Pavlović-Križanić and Ljiljana Brdarević

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EXECUTIVE SUMMARY

In the past several years, Serbian municipalities have made the first tentative steps to introduce public-private partnerships to the provision of the local government services. A desperate need for new investments in traditionally neglected sectors like public transportation, district heating and natural gas supplies, and solid waste management has pushed municipal authorities in Serbia to enter into public-private partnerships and to open their doors for more innovative approaches to the traditional forms of public service delivery. However, the number of successful public-private projects in Serbia is still quite small relative to the substantial need for municipal infrastructure revitalization and an increase in the quality of services.

Managed under a web of relevant laws on local self-government, utility services, concessions, public procurement, and public enterprises, PPPs currently operating in Serbia include contractual PPPs that assign the “the performance of the utility function” to the private investor and public-private mixed legal entities (institutionalized PPPs) that perform communal/utility services. Although no government agency has yet been established to coordinate or advise on the formation PPPs, local governments have been motivated to do so by the perceived benefits of supplementing tight public budgets with private financing, a desire to acquire private sector know-how, and a shift in local governance from an operating role to that of organizer, regulator, and supervisor.

Serbian local governments are only in the early stages of a process to establish the political, legal, and administrative frameworks that will permit and facilitate private sector development and public-private partnerships. At the moment, impediments for more vigorous private investments in the municipal public services occur mainly within a confusing and opaque legal environment and a risky investment market, and are a result of weak or incomplete institutional structures, a nonexistent general strategy for the reform of the utility enterprises, and the nonexistence of state-administered prices for utility services, etc. Moreover, municipalities have been insufficiently prepared to effectively manage the different aspects and phases of PPP arrangements.

For its analysis of PPPs in Serbia, this paper draws upon the experiences of the city of Belgrade’s struggle with its public transport sector to provide a secure, safe, reliable, and clean transportation. Similarly, the city has faced problems with refurbishing and expanding the Vin a landfill that handles most of its solid waste, in addition to establishing a large PPP to upgrade Belgrade’s water and wastewater network. Two smaller PPPs, the search for better parking revenues in the town of Kikinda and the maintenance of the town of Smederevska Palanka’s landfills, help to illustrate how PPPs are turning out for smaller municipalities than the capital.

The nascent experience of private participation in the Serbian public sector investments has revealed that municipal governments so far lack comprehensive experience in project

financing, structuring, and implementation. Therefore, they need immediate support if they are to undertake all the tasks and bear all risks related to soliciting possible partners, negotiating and preparing contracts, and maintaining any partnerships. These would involve financial, legal, administrative, and other areas of public administration.

1. INTRODUCTION

In the past several years, Serbian municipalities have made the first tentative steps to introduce public-private partnerships to the provision of the local government services. A desperate need for new investments in traditionally neglected sectors like public transportation, district heating and natural gas supplies, and solid waste management has pushed municipal authorities in Serbia to enter into public-private partnerships and to open their doors for more innovative approaches to the traditional forms of public service delivery. However, the number of successful public-private projects in Serbia is still quite small relative to the substantial need for municipal infrastructure revitalization and an increase in the quality of services.

Forms of the PPPs currently operating in Serbia are:

- Contractual PPPs—in all cases in the form of the “assignment of the performing of the utility function” to the private investor, and
- Public-private mixed legal entities (institutionalized PPPs) that perform communal/utility services.

It seems that Serbian local governments are only in the early stages of a process to establish the political, legal, and administrative frameworks that will permit and facilitate private sector development and public-private partnerships. At the moment, impediments for more vigorous private investments in municipal public services occur mainly within a confusing and opaque legal environment and a risky investment market, and are a result of weak or incomplete institutional structures, a nonexistent general strategy for the reform of the utility enterprises, and the nonexistence of state-administered prices for utility services, etc. Moreover, municipalities have been insufficiently prepared to effectively manage the different aspects and phases of PPP arrangements. Nascent experience of private participation in the Serbian public sector investments revealed that municipal governments lack comprehensive experience in project financing, structuring, and implementation. Therefore, they need immediate support if they are to undertake all the tasks and bear all the risks related to soliciting possible partners, negotiating and preparing contracts, and maintaining any partnerships. These would involve financial, legal, administrative, and other areas of public administration.

2. THE LEGAL AND REGULATORY FRAMEWORK

2.1 Contractual PPPs, Concessions, and Other Entities

2.1.1 Contractual PPPs

Serbia, like many other Central and Eastern European countries, does not have any governing laws on public-private partnerships. However, the existing legal framework does allow for different forms of cooperation between the public and private sector—from simple operation and maintenance contracts to the establishment of the institutional partnerships in the form of new legal entities.

The Republic of Serbia, an autonomous province, or a local self-government, may assign the performing of public services to private entities. These may be commercial entities (companies), but also other legal entities (nonprofit entities), as well as natural persons (entrepreneurs). In order for these subjects to be able to perform the above activities, it is necessary that the public entity assign the performance of these activities to the private entity under a contract, in which the rights and obligations concerning the performance of public interest activities are set forth. The aforementioned contract sets the rights, obligations, and liabilities of the parties.

The Law on Local Self-government (*Official Gazette of the Republic of Serbia* 129/07) provides for general legal ground on the establishment of PPPs *at the local level* in Serbia by allowing local governments (cities and municipalities) to attribute the execution of public services to a legal entity or a natural person through a contract. The Law on Local Self-government gives this authority to local autonomous governments, in addition to their “classical” power to create public utility enterprises (PUCs) or other organizations for the execution of such services. It is obvious that the above provision aims to simply present the two options a local autonomous government has regarding the execution of a public interest activity: either through a specially created public utility enterprise (or institution) or through the creation of a contract with a private investor or mixed legal entity established by the city/municipality and private partner. The said law does not give any detail as to the procedure for attribution of the municipal services by the establishment of the public-private partnerships.

Activities that represent natural monopolies in Serbia, such as filtration and distribution of potable water, filtration and draining of sewage water, steam and hot water production and supply, and tram and trolley bus transportation are utility services to be performed exclusively by the public utility companies. As public companies in Serbia are the only type of company that may be owned only by public entities (founders of the public companies may be only the state, autonomous provinces, and local self-

governments), in the utility areas that represent natural monopolies, complete or partial divestiture (as a sale of assets or shares of a public company to the private sector) is not legally possible at the moment.

However, if the founding of such an enterprise would not be “efficient” for public enterprises, the city/municipality may entrust this activity to a private investor. That is, local autonomous governments can allow private partners to perform utility services as natural monopolies only if the performance of such activities would not be efficient and economically sound due to the number of users, level of business activity, or otherwise. The Law on Utility Services provides that the municipality stipulates the requirements and manner of assigning the performance of utility services. It stipulates in the same act how the performance of the activity will be controlled.

By the Law on Utility Services, on the basis of the conducted procedure (public competition, tendering, or direct negotiation), an agreement on the assignment of tasks has to be reached. It has to be emphasized that the Law on Utility Services allows for the exceptional cases when the municipality may assign a private partner to execute utility services *without a competitive process*. The law requires that the special commission selected by the municipality organize the awarding procedure. This commission will examine the submitted offers and will negotiate accordingly.

The law further provides that a public interest activity may be attributed to such a private enterprise for a five-year period, unless it is attributed to an enterprise that has committed itself to invest in the said activity, in which case the attribution shall be for a period necessary for return on investments and not more than 25 years. At the end of the aforementioned period an enterprise shall have the right to bid under the same conditions as other interested enterprises to obtain future attribution of the activity. The municipal assembly sets forth the rules and conditions for this competition. When assigning public utility services, the state, autonomous province, and/or local government are entitled to control the performing of the activity, to determine prices, and to otherwise exercise impact over performing of the activity.

The relevant provisions of the Law on Utility Services which became law prior to the Law on Concessions, includes a period of five years for the contract, increasing to 25 years to amortize investments. A tender procedure and an organization to award contracts are probably not applicable to PPP transactions, and may indeed (at least as they relate to tender procedures) be inapplicable and rendered obsolete by the Law on Concessions and the Public Procurement Law, since municipal concessions would be awarded under the Law on Concessions and traditional public service procurement would be covered by the Law on Public Procurement.

Performing public utility services under the operation and maintenance contract of a private operator does not offer the private party the opportunity to autonomously engage in or operate activities, that is, without the supervision of the public partner. Moreover, in the area of the tariff setting, the operation and maintenance contract

gives a limited space for a private partner to influence criteria for setting the price of products or services performed. Article 3, paragraph 3 of the Law on Public Enterprises and Performing Activities of Public Interest states that private entities performing the public services would have the same duties and responsibilities in the performing of public service, as a public enterprise or public institution. That provision implies that in the area of the tariff setting, the city/municipality (and also the government of Serbia) will retain the right to approve a private partner's price change. Even when there exists a direct link in the PPPs between the private partner and the final user (for example, the Belgrade public transportation case), and the private partner provides a service to the public, the city/municipality retains the right to control the level of charges levied on the users of the service. If necessary these charges can be supplemented by subsidies.

As already mentioned, award of the operation and maintenance contract should be performed in compliance with the Law on Public Procurement. This Law sets a legal framework of public services attribution for private investors seeking to reduce the possible procurement risks for procuring entities (including local governments) such as a lack of technical capacities and skills, which they may encounter. The objective of the law is also to ensure competition, transparency, and to prevent abuse when disposing with funds from public revenues.

The Law on Public Procurement sets a very detailed procedure for the procurement of services. The attribution of contracts for public procurement of the services may be done according to three methods: open procedure, restricted procedure, and direct negotiation. The main characteristics of the open procedure is that all interested parties may participate, without the previous selection of only certain entities and an advertisement with an invitation to tender must be published in the *Official Gazette*. The restricted procedure includes a two-phase procedure, the first phase being the prequalification phase. According to the Law on Public Procurement, such procedure may be applied only where the object of the public procurement are either goods, services or construction works which can be performed by only a limited number of bidders with adequate technical, human, and financial resources. It should be noted that the Law on Public Procurement sets some preconditions for the awarding of a public procurement contract. The procurement should have been previously included in the program of public procurements and funds for the procurement should have been allocated in the budget of the city or municipality.

2.1.2 Concessions

There are no public-private partnerships on the national level in Serbia. The most important reason for this is because of a highly complicated and extremely lengthy concessions contractual procedure. For instance, the government of the Republic of Serbia is required

to make a decision on a concession proposal within three months. After that, the line ministry has six months to prepare and submit a draft concession act to the government. So, from the moment a concession contract initiative is conceived to the moment a tender procedure is started, anywhere between one year (best case scenario) to two years, can pass before a decision is reached. Local governments find the complexity of concession procedures to be insurmountable hindrances. This goes even for cities that have highly developed technical, material, and professional resources, including Belgrade. That is why the concession procedure for the landfill in Vinča lasted, with interruptions, for more than three years, until it was suspended until further notice.

2.1.3 Mixed Legal Entities

Bearing in mind that Serbia still has not begun the process of privatizing its utility companies, the existing legal framework is not very supportive of institutional PPPs at the local level. According to the Law on Utility Activities, a public enterprise, which performs utility functions, can be sold (privatized) only *up to 49 percent of its capital*. However, public enterprises that perform filtration and distribution of potable water, filtration and diverting of sewage, steam and hot water production, and supply tram and trolley bus transportation may not be privatized, even partially. The said provision is not at all a limiting factor for the introduction of the private sector to the activities of public utility enterprises through privatization in the sectors that do not represent private monopolies. Still, it is not clear whether a private partner has the right to additionally invest in the enterprise and to consequently increase its share in it.

2.2 Government Management and Control of Public-private Partnerships

As previously explained, Serbia still does not have a law on public-private partnerships. The previous government of Serbia had a very ambitious plan to establish a unit of government for public-private partnerships within the Ministry of Finance. This unit was seen as the very first step towards the establishment of a “special purpose authority” to be charged with overseeing the implementation of public-private partnerships. The unit would be given special authority to assume the responsibility of acting as a liaison between all parties, including other government departments, to organize and execute planning and feasibility studies and conceptual design frameworks, to establish financial demand models, and to negotiate with development banks and other potential funders. It remains to be seen whether the incumbent government will continue in the same direction.

At the moment, the government has a very limited *ad-hoc* role in the process of the establishment of the public-private partnerships at the local level. Moreover, if public-private partnerships are organized as “operation and management contracts,” then the role of the state does not exist at all. In the concession agreements and in partial privatization contracts (the establishment of the new business venture or selling the state capital of the local utility company), the government has to be consulted, and needs to approve the transaction. Namely, each sale of assets or shares of a state-owned entity has to be approved by the Serbian government. Only the government has the authority to decide on the acquisition and sale of the shares of state owned enterprises (state capital in public enterprises). All contracts signed contrary to the provisions of this article are null and void. However, after approval of the partial divestiture, the government has no mandate to oversee the implementation of the PPP agreement.

The Serbian government’s role is the most important in the concessions agreement awarding process. This notion is still theoretical as there are no operational concession agreements at the local level so far. The Serbian Law on Concessions sets forth the responsibility of the government to oversee the awarding, implementation, and operation of the PPP contracts. However, as already mentioned, Serbia still does not have implementation agencies charged with the sole responsibility of overseeing PPP concessions (and probably even contractual PPPs). It seems this is an urgent need in Serbia, where institutions are still fragile, the level of corruption is rather high, the infrastructure investment market is still considered risky, and comprehensive experience in project financing, structuring, and implementation do not exist.

3. MONITORING AND EVALUATION—LESSONS LEARNED

3.1 Assessment Techniques

Rapid urbanization and growing demand has increased the need for investment in infrastructure development in the Republic of Serbia. The limited availability of funds for the provision of infrastructure development has widened the divide between requirements and supply. In current terms, the investment requirement far exceeds the availability of budgetary allocation. The local governments, therefore, have been encouraging public-private partnerships (PPP) to attract market investment, thereby leveraging local government budgetary resources to meet the provisions for infrastructure and public services.

A PPP is recognized in the Republic of Serbia as a general long-term contract between a public sector entity (central and local government or a public sector corporation), and a private business, covering the design, financing, operation, and maintenance of public

infrastructure or the design, financing, and provision of a service. A public-private partnership is a contractual agreement between the public and the private sectors, whereby the private operator provides services that have traditionally been executed or financed by a public institution.

Legally, it is midway between simple public procurement and privatization as a means to providing a public service, and therefore may be used to transfer a large proportion of the risk to the private sector. The ultimate goal of PPPs is to obtain more “value for money” than traditional public procurement options would deliver. Although the *ex ante* assessment of expected value for money is often extremely complex, in general, a PPP can be said to generate value improvements whenever it produces the following advantages: reduced life-cycle costs, a more efficient allocation of risk, faster implementation, improved service quality, and additional revenue.

Recent years have seen a marked increase in cooperation between the public and private sector for the development and operation of infrastructure for a wide range of economic activities. The establishing of PPPs in the Republic of Serbia has been driven by a combination of several factors: (a) the search for private financing to supplement tight public budgets, (b) the desire to acquire private sector know-how and operating skills, and (c) the structural change in the role of local government, which is becoming an organizer, regulator, and supervisor rather than a direct operator.

This section contains a short overview of the main types of PPP transactions selected for implementation or established by local governments in Serbia. Options of PPPs range from those involving minimal private sector involvement, such as through the use of service contracts, to those involving extensive private sector participation in public sector entity management and infrastructure rehabilitation and investment, such as concessions and BOT arrangements. In almost all these options, the public entity typically resumes full control of the assets upon termination of the contract with the private partner. The following discussion introduces each of these options.

The examination of case studies enables the identification of the key principles governing PPP development and application in the local governments of the Republic of Serbia. It is important to emphasize that PPP structures are an evolving concept in their early stages.

While the benefits of partnering with the private sector in PPPs are clear, such relationships should not be seen as the only possible course of action and are indeed complex to design, implement, and operate. Therefore PPPs need to be carefully assessed in the context of the project, the public benefit, and the relative gains to be achieved under various approaches.

The number of cases presented is obviously small compared to the number of actual projects and agreements initiated and realized. The main problem in researching the established PPP structures has been a lack of willingness among local governments to disclose a PPP contractual agreement and to share their experiences during the assess-

ment, procurement, and negotiation processes. Data has been collected from a variety of sources including project financiers, sponsors, and beneficiaries. In order to facilitate an analysis of cases, the following criteria were selected: contract type, contract duration, value of investment, transfer of responsibility, demand risk, availability risk, market financial risk, and price risk.

An analysis reveals a number of variations between the PPP models adopted. The following conclusions were made, based on the assumed criteria:

- **Contract Type.** Service and management contracts are the most common forms of PPP structures encountered. The concession cases analyzed here have not been fully realized yet. Joint companies are registered in the field of waste management and gas distribution. However, the structure of contract type demonstrates the lack of local governments interest in making a comprehensive assessment of an appropriate PPP structure. Different PPP structures could be explored based on the extent of funds that could be diverted from public sources and those required from the private sector, service levels targeted, willingness to pay and affordability of consumers, and rehabilitation of the existing systems, etc. Local governments prefer to enter into service and management contracts instead of concession contracts. This is because the service operator selection procedure is shorter and easier than the complex legal procedure for the assessment and implementation of concessions and a concessionaire selection through an open competition procedure (public procurement). Moreover, not assessing the appropriate PPP structures results in the loss of additional revenue for the public sector that could be realized through the collection of local fees for the use of existing public assets and for the right to perform revenue generating public services by a private party. Founding a joint venture company represents an additional risk in when considering a concession. The founding of these companies in Serbia does not generate concession benefits, and is followed by the loss of property rights over the public property, the weakening of the negotiation capacities, and a loss of local government control.
- **Contract duration** has to be identified with regard to the relationship between the amount of capital invested, the degree of private sector involvement, and the length of time required to ensure investment and profit recovery. Unfortunately, contract duration is regulated in accordance with the aforementioned criteria only in case of a concession establishment, pursuant to the Concession Law. The contract durations for other PPP transactions involve private partner offers and a negotiation process between the two parties, without applying the calculation of a payback period for the investment. These duration structures are also indicative of the fact that Serbia has not developed long-term markets for infrastructure operations. As a result, concession contracts, and even service and management

contracts involving small investments in revenue generating services with short payback periods, last more than 20 years and tend to dominate.

- **Value of Investment.** The water and sewage sectors represent the largest capital investments. This is to be expected given the scale of projects and the investment requirements. For example, the necessary capital for investment in Belgrade water and sewage is estimated at nearly EUR one billion. The smallest financial investments involving the least risky financial consequences are with parking services and solid waste management. These investments range from EUR 0.6 to 40.0 million. Therefore, PPP arrangements in parking service and solid waste management involve shorter payback periods and lower risk exposure for private partners. As a result the private capital inflows are predominantly registered in sectors that seek smaller investments.
- The **transfer of responsibility** is the degree to which the private party is involved in the project as defined by the contractual model and obligations, ownership of assets or operating rights, and the project operational structure. According to reviewed cases, the responsibilities are distributed in relation to the characteristics of the project and the parties. The transfer of responsibilities is set forth in the tender documents and the final contracts. The solid waste, parking, and gas distribution cases demonstrate the highest degree of transfer of responsibility onto the private party. This is often in relation to the more commercial nature of investments in these operations, for which the private partner is expected to finance and assume demand and market risk.

The service contract for Belgrade public transportation shows that the private partners are responsible for the procurement and the operating and maintaining of the asset for a short period of time, while the city bears the financial and management risks. Revenues for the private partners are linked to performance targets. The concession for solid waste in Belgrade gives a private partner responsibility for the design, finance, construction, operation, and maintenance of a utility's assets and then transfers it to the government when the contract ends. Revenues for the concessionaire are linked to performance targets and commercial risks.

- **Demand risk** is the degree to which the risks of variations in market demand, competition, or technological obsolescence are passed onto the private party. According to the previously described criteria, the solid waste sector and parking services have the highest degree demand risk transfer onto the private party. The real level of passed demand risk depends on the development of the service and beneficiary's coverage by the service assigned to the private party. The risk may be significantly reduced by a monopolistic position of a utility service operator.

For example, the demand risk assigned by a concessionaire who will operate solid waste services in Belgrade is estimated to be very low, due to the existence of developed communal services in the field of waste collection and disposal in the city and stable growing standard of life of the citizens. On the other end, demand risk in solid waste for the Smederevska Palanka municipality is estimated as significant, as there are a lot of households in rural settlements that have never used this communal service. Fee collection from these beneficiaries will affect the earnings of the private partner, particularly at the beginning of the operation.

- **Availability risk** is the degree to which the private party risks delivering against the contractual specifications, fails to meet standards and quality levels, delivers services against specifications, or fails to meet agreed upon volumes. The risks under this category are distributed between public and private partners in all reviewed PPP cases. The private partner is usually responsible for the quality and efficiency of the rendering of assigned services under the contractual provisions. The public party is the guarantor of good performance and delivery of utility services to the citizens.

In the case of Belgrade, the concessionaire would have full responsibility for the design, financing, construction, and operation of the new infrastructure and service delivery to the citizens. The city government is responsible for the supervision of the concession, with a full right to cancel the contract if the concessionaire fails to fulfill its contractual obligations. This right enables the city to guarantee good performance and delivery of services to the citizens. The same regulation is included in other PPP agreements analyzed.

- **Market financial risk** is the degree to which the risks of variations in market indicators such as consumer prices, interest rates, the dinar exchange rate, petrol prices, average gross salary, etc., are passed onto the contractual parties of PPP. Many of the cases demonstrate that market financial risks are incorporated within the calculation and adjustment of the price of utility services.
- **Price risk** is the degree to which the risk of variations in the efficiency of a private partner's operation and the tariffs collection are passed onto the service beneficiaries. Pursuant to reviewed contracts the service beneficiaries are not exposed to significant price risk, which could be caused by a private partner. In all cases, the price of utility services shall be regulated and adopted by the local assembly in accordance with contracted criteria. The main criteria for price adjustments are official market indicators that have an impact on the costs of service operation.

For instance, the service contract for Belgrade public transportation regulates the structure of total costs of the private partner and the relation between each type of cost and matching market indicators. Consequently, there is no place for tariffs correction as a result of increased costs and the inability of a private partner to fully realize their potential.

3.2 Managing PPP Deals

3.2.1 Why Changes Were Needed

In all of the municipalities analyzed there is the need to invest in order to enhance the existing infrastructure and develop the communal services. An example for such a need to invest is the construction of the waterworks and sewage system in the city of Belgrade. An example of the undeveloped communal activity is the municipality of Smederevska Palanka that needs to develop its capacities in the treatment of the solid waste, and also the municipality of Kikinda that does not have a developed parking service with the necessary infrastructure. In these mentioned cases, local governments were not able to assure investment in the deficient infrastructure directly from the budget.

At the same time, these municipalities have already made use of their crediting capacities by taking credit loans from financial institutions. In that sense, the only possibility they had was to attract funds from private partners that were interested in making profit by investing in local infrastructure and by taking over the commercial risks in performing communal services. We need to stress, however, that the PPP case of public transportation in Belgrade was not motivated by a lack of funds exclusively, but also by the need to create competition in public service delivery and to enhance service quality.

3.2.2 How Was the Municipal Decision Made?

Local governments are obligated by the Serbian Constitution and the Law on Local Self-government, as well as by the Law on Utility Activities, to ensure conditions for performing public activities, regulate the way the activities are performed, enable assets for work and development, and supervise the performance of public activities. To this end, the local assembly decides who will perform each public activity through the adopting of the decision on the establishment of public entities (institution, organization, or enterprise) or the decision on granting performance of the activity to a private enterprise or entrepreneur.

In order to meet the aforementioned legal obligations, Serbian local self-governing units faced a lack of assets and skills for the development of core utility activities. Because of the lack of budget resources to be invested in the construction of needed assets and further development of public activities, the local governments decided to attract private partners to invest in and to take over the management of these activities.

Following this idea, most local governments decided to establish PPP structures based on the lack of public resources for investment in utility assets and operations. The way to assess a feasible and adequate PPP transaction depended on the knowledge and experience of local governments in performing capital project financing and comprehensive capital assets and financial management.

The most successful approaches to adequately assess PPP transactions are registered in the capital of Serbia. Supported by well-experienced international institutions and consultants, funded from foreign grants, the Belgrade administration made a decision on PPP transactions based completely on legal, financial, economical, environmental, and technical due diligence, and an analysis of the existing utility system and its operations. These examples are in the cases of PPP establishment in public transportation, solid waste management, and in the water and sewage system of the city.

As far as other municipal local governments are concerned, most of them made decisions on PPP establishment according to the expected value of the investment by a private partner and offered tariff levels that would be paid by the beneficiaries. Prior to making their decisions, they did not analyze the state of the utility service and the financial and economic effects of selected PPP transactions on municipal assets.

3.2.3 Arguments For and Against at the Municipal Council

The main argument for PPP establishment is grounded in the possibility of achieving benefits for service consumers and the local government, as the result of a private partner's participation in infrastructure investment, public service operation, and management. The usual benefits for entering into a PPP transaction recognized by a municipal assembly are:

- Enhances efficiency through the introduction of commercial principles in utility system operation;
- Improves the level and quality of utility services;
- Ensures long term financial, technical, and environmental sustainability of the utility system, taking into account end-user affordability;
- Introduces a highly functional system of paying for and carrying out the control of utility activities;

- Develops nonexistent utility services through the introduction of the private partner's technical skills and experience; and
- Improves revenue collection for the municipal budget.

The main arguments against the establishment of PPP that may arise during discussion in the local assemblies are:

- Using the financial and economic data generated by an inefficient utility system as a baseline for establishment of the contractual performance criteria for the new PPP arrangement;
- Entering the PPP transaction without performing analyses of financial and economic effects of the selected PPP model among possible alternatives;
- Lack of skilled and experienced people from the municipal side to be involved in negotiation with proficient and specialized private sector partners;
- Loss of control over public assets and resources;
- Fear of the unpredictable effects of applying the full cost of recovery principal when tariff setting for a utility service.

3.2.4 How Did the Tendering, Selection, Contracting Process Go?

According to Serbian legislation, local government units are permitted to award service and management contracts through public competition pursuant to the Law on Public Procurement. The Law on Concessions regulates the granting of concessions in great detail through an open bidding procedure. The Law on Public Enterprises permits the establishment of a joint venture company and the performing of general interest activities without regulating the private partner selection. Hence, there is space for direct negotiation between local governments and the private partner about establishing a joint company without engaging in the competitive selection of a partner.

Analyzed cases show that private partners were selected via a public competitive bidding process in accordance with the relevant law. In the cases where service management contracts were granted, all local governments applied their experience, acquired from the legally based service procurement procedure, during the preparation of tender documentation. The content and form of tender documentations was prepared in accordance with the Law on Public Procurement. Public invitations for the competitive bidding process were published in the *Official Gazette* and daily newspapers. Interested candidates were required to be qualified to carry out the required utility services and to submit technical and financial bids, which are supplemented with bid bonds for the

tender procedure. A criterion for the selection of the best bid was the most economically advantageous bid, which was selected on the basis of the following subcriteria: technical solution for utility service and the total value of investment and service tariffs.

The concession for the Belgrade landfill would be granted through international tender **governed** by the Serbian Concession Law and the concession enactment of the PPP project, approved by the government of the Republic of Serbia. Tender documentation included all necessary elements and instructions for the preparation of the bids and a “memorandum on tender procedure,” which included, aside from the rules for submission of the offer, other elements relevant to the tender procedure. Interested candidates were required to be qualified and to submit a bank guarantee for the tender procedure. The tender procedure has two phases: the first phase is the evaluation of technical offers, and the second phase evaluates financial offers by all candidates whose technical offers met the minimum requirements. These two phases are followed by a joint evaluation of qualified candidates’ technical and financial offers. The preferred bidder will be selected on the basis of the combined evaluation of the technical and financial offers. Finally, the Negotiation Committee will finalize the closure of the concession agreement with the preferred bidder.

3.3 Methods of Monitoring and Evaluating PPPs

Successful PPPs require an effective legislative and monitoring framework, as well as the recognition by each partner of the objectives and needs of the other. Guaranteeing a benefit from a PPP requires the recognition of the strengths and weaknesses of each type of structure and the aims and objectives of each party. In this respect, the role of the public sector, which may transform itself from a service provider to a supervisor of service contracts, is of particular importance. This section provides an overview of the existing PPP models within the Serbian local government, and methods by which the PPPs have been monitored.

3.3.1 The Private Partner’s Contractual Obligations

The obligations of the private partner are very clearly stipulated by the contract in most of the reviewed PPP transactions. This is the main precondition for successful monitoring and evaluation of the established PPP transaction from the view of the local government. The following private partner contractual obligations are reviewed in several case studies.

In the case of granting the concession for performing treatment and disposal of solid waste in the city of Belgrade, the main obligations of the concessionaire shall be: to rehabilitate the landfill and improve the quality of the services, to enhance efficiency

and lower costs through the introduction of commercial principles, and to perform communal services under the contractual provisions.

The private transportation companies which entered the operation contract with the city are obliged: to finance procurement of a certain number and quality of vehicles and to perform city public transportation pursuant to the provisions regulated by the city.

For example, in the case of awarding a contract for parking services operation of the municipality of Kikinda, the obligations of the private partners are: to develop parking services through investments of EUR one million, to perform parking services by introducing commercial principles, and to introduce a highly functional system of paying for and carrying out the control of parking activities.

3.3.2 Providing Performance Guarantees by the Private Partner

In order to assure quality and efficiency in the rendering of awarded services within the agreed period of time, the concessionaire is obliged to submit a performance guarantee: **for the construction period** (10 percent of planned investment value for the construction period) and **for the operation and maintenance period** (five percent of planned investment value for the operation and maintenance period).

The concessionaire shall also maintain in full force and effect throughout the concession contract following **insurances**: contractors, pollution legal liability, all risks, third parties, professional responsibility, workers, and property.

On the other hand, the private partners are not obliged to submit a performance guarantee by most of the operation and management contracts. These agreements regulate the responsibility of the private partner to deliver quality services and to insure the permanent functional ability of the utility's assets, but without any collateral instrument to be activated by a local government in the case of bad performance.

3.3.3 Monitoring of the PPP Contract Obligations

The cases presented here show that the monitoring of and carrying out of private partner contractual obligations is the responsibility of the local government. In this respect, all contracts regulate the private partner's reporting roles and procedures during the PPP duration.

For example, the concessionaire shall maintain records and prepare reports during the concession duration and submit them to the city of Belgrade. These reports shall include records on: amount, type and origin (municipality) of the solid waste. The city, as a grantor, shall have free and open access to the landfill and all facilities for purposes of inspections.

The city's public transportation board is responsible for executing the service contract provisions by private companies. Thus, the board is obligated to perform the ongoing quality control of services delivered by private companies. The board can do this on its own or with the commitment of a third legal entity.

In the municipality of Kikinda the traffic department is responsible for overseeing the parking service assigned to the private company. The key point in operation and management contract supervision is to control revenues collected from parking services that are shared between the municipality and the company. This is enabled by a modern software package for the online management and operation of the parking service, created by the company.

3.3.4 Monitoring of Performance Standards for Users

Performance standards for users should be regulated by the PPP agreements in order to ensure the delivery of high quality services to citizens. This is the case with the service contract for public transportation in Belgrade.

Citizens play an active role in the assessment of the quality of public transportation. They can make complaints regarding public transportation to the transportation board. The regulated identification of transportation department vehicles and staff allows citizens to submit their complaints regarding noted irregularities within the public transportation system.

The public concession for solid waste also regulates a concessionaire's responsibilities to its customers. Concessionaire reports will include any complaints that may have been articulated by the users and describe the solutions and remedies carried out by the concessionaire in relation thereof. Private parking service and solid waste operators have to create an overview of the quality of services delivered to their users.

3.3.5 Contract Termination

All contracted PPP agreements contain a provision regarding contract termination in case of a private operator's failure to perform. In accordance with this provision, a local government unit has the full right to cancel the contract if the private partner fails to fulfill its contractual obligations. This right enables the municipality to guarantee high-quality utility services to its citizens. In the case of contract termination the municipality may have a preemptive right to purchase previously constructed and installed assets. The notification period allows the municipality to further regulate service performance in case of contract cancellation. If the private partner terminates the contract, it is obligated to cover all costs that have been incurred by the municipality following the contract cancellation.

3.4 What Are the Initial Experiences?

The initial facts about the implementation of PPP in Serbian local governments are difficult to evaluate because all the contracts are in the early stages of implementation and operation. Nonetheless, some conclusions can be drawn at this stage.

In all of the implemented PPPs to date, the private partner was given incentives for the timely delivery and operation of project assets. The main reason for this is the accepted commercial risks of the utility service operation contained in the “no service—no pay” principle. Hence, all investments were completed within the agreed upon time frame. The private partner was further encouraged to find innovative means to manage the operational risks that came with the project. The most visible result of implemented PPPs in Serbian local governments was a significant improvement in the quality of services delivered by the private partners.

In Belgrade, the implementation of the service contract for public transportation enabled the city to: expand public transportation infrastructure plants by 30 percent without dipping into public resources; create a competitive framework for the public transportation operator that resulted in an increase in efficiency and profitability; and improve the quality of services delivered to citizens without an increase in tolls.

Implementation of a parking services operation contract in Kikinda resulted in: the development of parking services with a functional system for paying for and carrying out the control of parking activities, and the establishment of a new parking system and payment method by text message that led to better quality for users.

Implementing the contract for the maintenance and sanitation of landfills in the municipality of Smederevska Palanka has resulted in the elimination of illegal waste dumps, the development of waste management, improved sanitation, and the growth of landfill capacities. The contract has also met the needs of citizens whose focus was on environmental protection, healthier living, and a more aesthetically pleasing surroundings.

The municipality must review operation reports and financial statements from its private partners to evaluate the financial effects on the local budget. Unfortunately, we have no data from the submitted reports to make adequate comments on the achieved financial results of PPPs.

4. RETHINKING THE SERBIAN PPP APPROACH

4.1 Identification of the System Inefficiencies

Public-private partnerships have a very short history in the Republic of Serbia. Since all PPPs have been established recently, it is difficult to offer an overall and accurate assess-

ment of the effects of the established partnerships, especially since there is no organized monitoring of the way PPPs are established in Serbia or of the effects of those so far established ones at the state or local level. Examples analyzed in the previous section could make one believe that the PPP development is more successful than it really is.

Here, we analyzed PPP cases from municipalities that were willing to share their experience, as they obviously respected the legal framework, received foreign aid, and received consultants' input in the creating and establishing of PPPs. As for other PPPs that have been established, we cannot comment on them, as we have no data on the nature of their constitution. Because we lack financial and economic indicators that track PPP effects, we will analyze the practice of establishing PPPs in Serbia, explaining the risks that may occur during the implementation phase in the following section.

An increase in partnerships, primarily in local communal service and infrastructure development and regeneration, was the result of a range of conditions and prerequisites found in Serbian local governments. They included addressing the challenges and tasks confronting local governments as a consequence of structural economic transformation, changing market conditions and intensifying competition, and the search for new approaches in order to meet these challenges.

The number and composition of public and private participants in partnership projects are not subject to definite rules, and they differ from one case to the next. In spite of these differences, however, partnership participants have much in common:

- participants from the public sector are predominantly local government representatives, and
- private sector partners are financially powerful actors like property developers and large groups of companies engaged in a broad range of public services and infrastructure development sectors, or a wide variety of firms operating in sewage and waste disposal.

The expectations of public and private partners concerning cooperation differ according to their specific functions and roles. The public sector, which in the majority of cases is the initiator of PPP projects, expects: a mobilization of private funds, relief with regard to limited local budgets, access to the professional competencies and capacities of the private sector, and the accelerated and professional completion of projects.

Private actors set high hopes in the completion of joint ventures because of the promised access to local powers and authorities, greater influence on planning procedures and decisions, and well-funded and largely risk-free project implementation.

In the Serbian municipalities, PPPs may be set up for all public local services as long as there are no statutory obstacles. Where partnerships are actually established and for what purpose depends, as Serbian experience has shown, on one crucial factor: whether the private partner can earn a profit from a satisfactory return on his investment or from sufficient public subsidies.

Project priorities for PPPs are, first of all, construction, communal services development, and infrastructural improvements in most cases. As a rule, these are projects that are expected to improve the local area or the city concerned. Private partners showed increasing interest in the profitable areas of city transportation, gas distribution, and waste management infrastructure. Apart from these activities, “practical” projects (like renovation, operation, and management) within a wide range of public facilities should be encouraged by Serbian local governments.

As experience with projects from different local governments and different countries shows, Serbian local governments may be confronted by a series of potential problems and dangers during a lifetime of recently established PPPs. These include, in particular:

- A reduction in control and influence for democratically legitimized representatives at the local level, as a result of the special situation frequently created in public-private cooperation (exemption from the normal administrative process, reduction of the public domain to a very few protagonists relevant to urban planning and development policy, etc.);
- A waiver of long-term, strategic perspectives in favor of comparatively short-term commercial calculations, as a result of a increased influence of profit-oriented thinking on local authority planning, planning aims, and priorities;
- A reduction in local competencies and maneuverability resulting from the transfer of local authority and responsibility to private partners; and
- An unequal distribution of risk between partners, often imposing unforeseen procedural difficulties and financial deficits on the public sector.

Whether or not these problems actually occur depends on a number of factors, not least of all on objectives and interests, and the quality of information and qualifications of public protagonists contribute to cooperative undertakings with private business.

4.2 Proposals for Improvement

Fundamental requirements for successful PPPs are:

- A credible legal and regulatory framework that protects private sector interests and property rights and enables commercial contracts to be legally enforced;
- Government agencies with the necessary authority to grant concessions and licenses, whether through specific concession laws or other implementing legislation or regulations; and
- Mechanisms to permit the resolution of disputes and potential conflicts of interests in a cost-efficient, fair, and enforceable manner.

Successful PPPs deliver high-quality services to consumers and the government at significantly lower cost than would be the case with public investment and government provision of the same services. An appropriate institutional framework is critically needed if PPPs are to succeed. The challenges in this relationship are numerous in the Republic of Serbia, an emerging market economy.

Political commitment and good governance are prerequisites for the success of public-private partnerships. A PPP is a major commitment on the part of the private sector, which needs to know that politicians are also committed to private involvement. Uncertainty in this regard gives rise to political risk that is not conducive to making long-term business decisions. Therefore, it is important to establish clear channels of responsibility and accountability for government involvement in PPPs. An appropriate legal framework can provide reassurance to the private sector that contracts will be honored. This requires changes or additions to existing laws in Serbia.

The Serbian government should develop a detailed and explicit policy on PPPs that would govern PPPs at all levels of government, and place an emphasis on value for money, with the public interest as a key feature of the policy. This policy would complement existing legislation in the fiscal area, including the Concessions Law and the Procurement Law. It should be useful to consider the establishment of a competent body to be responsible for overall coordination of the PPP program and the approval of specific projects.

PPPs require the development of expertise in the government. This covers the full range of skills required to manage a PPP program. Particular attention should also be paid to skill development by subnational governments, since in many countries the responsibility for spending in areas that are likely candidates for PPPs is transferred to them.

The government will also have to refine its project appraisal and prioritization. First and foremost, the decision whether to undertake a project, and the choice between traditional public investment and a PPP to implement it, should be based on technically sound value-for-money comparisons. It is particularly important to avoid a possible bias in favor of PPPs simply because they involve private finance, and in some cases generate a revenue stream for the government.

The PPP policy/regulation has to contain provisions to minimize the exposure of private partners to institutional risk. Key elements to contain the risk of non-payment by the government include: (1) granting seniority to PPP contract payments over other categories of expenditure, except for debt service and constitutionally mandated spending; (2) permitting private partners to pledge future payments from a PPP contract to financial institutions; (3) allowing the earmarking of revenue to meet PPP contract payments; and (4) the creation of trust funds to guarantee PPP contract payments.

5. CASES OF PUBLIC-PRIVATE PARTNERSHIPS

5.1 Public Transportation in the City of Belgrade

Case Study	Belgrade city awarding a service contract for public transportation
Objectives of PPP	Quality improvement and extension of the public transportation infrastructure
PPP Actors	City of Belgrade, public transportation department and licensed private transportation companies
Financial Structure	Own or borrowed resources from private partners
Foreign Grants	No
Contract agreement	Service contract
Contract duration	7 years
Risk allocation	Commercial risk is assumed by the city
Management	Transportation department controls contract performance
Tariff setting	City, pursuant to the contractual agreements
Strong Points	Create competitive framework for the operation of PUC GSP. Investing in public infrastructure, without spending public resources.
Weak Points	Commercial risk is assumed by the city through guaranteed level of revenue for the private partners according to delivered services.

The Belgrade case illustrates a way of establishing a partnership with private transportation operators. These private operators had to show their qualifications for performing public transportation services and a capacity for investing in transportation infrastructure. The PPP is aimed at establishing and improving the quality standards for public transportation in Belgrade.

5.1.1 Background

Belgrade's public transportation services are handled by: PUC GSP "Beograd" (buses, trolleys, and trams), private bus transportation companies, taxis, SP "Lasta" (suburban and local bus transportation), Beovoz city railway, and express minibuses. Private bus transportation companies appeared in Belgrade's streets in 1997 because the PUC GSP was unable to provide public transportation services on its own, due to the financial

deficits. Private companies required payment for single tickets, independent from the tickets and toll system applied in the PUC GSP buses.

During 2005 the city government recognized the possibility for the implementation of an integrated toll system for the city's public transportation system. The integrated toll system consolidated operations of the PUC GSP and the private transportation companies and the use of single tickets and pre-paid passes by the citizens in both PUCs and private buses. Therefore, the city awarded public contracts to qualified private transportation companies that had submitted the best bids to carry out public transportation services. Thus a PPP was established between the city of Belgrade and the private transportation companies by using the best practices from developed market-economy countries.

5.1.2 The main principles of established PPP

- **Possibility for achieving benefits for both the city and the private partner.** The city should achieve the improvement of the public transportation infrastructure, without spending budget resources and PUC's revenues for the procurement of the new vehicles. Moreover, the city has created a competitive framework for the operation of PUC GSP that should result in an increase in efficiency and profitability. The private transportation company, by entering into the contract, insures its long-term revenues for the next seven years, which depends on the performance of public transportation. Meeting the contractual obligations enables the private company to generate profit, which does not have to do with the variance in number of passengers using public transportation.
- **Private partners are selected by public competition.** The content and form of tender documentation were prepared in accordance with the Law on Public Procurement of the Republic of Serbia. Each private transportation company, which assessed the tender, had to prove its qualifications for carrying out public transportation services and their ability to insure a rolling plant as stipulated in the technical specifications.
- **The private partner is obligated to invest in a rolling plant,** according to the condition from the tender documentation (certain number and quality of vehicles). Showing financial capacity for the procurement of a rolling plant was the key criteria for the qualification of the private partner during the tender procedure.
- **Revenue realization of the private partner is guaranteed** and calculated on the basis of realized effective kilometers and the contracted price of transportation delivered. The revenue is collected from the following resources: (1) from

an integrated toll system (2) from the selling of the single tickets on the buses, and (3) from the city budget to complement a guaranteed level of revenue.

- **Risks are shared between the parties during the contract's lifetime.** *Demand risk* is accepted by the city due to the price of tickets, and is subsidized by the budget. *Market financial risks* (consumer prices, petrol prices, dinar exchange rate, and average gross salary) are incorporated into the calculation and adjustment of the price of public transportation. This price is adopted by the city government, in the proposal completed by the public transportation department pursuant to the methodology regulated by the contract. *Damage risk* is covered by an insurance policy. *Risk of outperforming the contractual obligation of the private partner* is covered by a guarantee issued by a bank.
- **The contractual obligations of the private partner are** to finance procurement of a certain number and quality of vehicles and to provide public transportation services across the city.
- **The carrying out of transportation public services is regulated by the contract.** The public transportation department is obligated to perform the ongoing quality control of services delivered by private companies. The board can do this on its own or with the commitment of a third legal entity. In this respect it controls the following criteria of public transportation quality: the contracted level of services, the frequency of service delivery, the availability of equipment, the cleaning of vehicles, and the informing of citizens.
- **Contract termination in case of bad performance.** The contract may be canceled by the private partner, but not prior to the time defined in the contract. The public transportation department may terminate the contract at any time when establishing the fact that the private partner failed to perform its contractual obligations.
- **Delivering high quality services to the citizenry is guaranteed by the contract** that regulates the following: the number of vehicles for public transportation on the awarded lines, the number of reserved vehicles, the timetable of transportation, the marking of the vehicles, the method of informing and advertising in the vehicles, the selling of the tickets in the vehicles, the dress code and identification of staff on the vehicles, the emergency measures in case of accidents and unpredicted events, the maintenance of rolling plant, the public security in the vehicles, and the submission of monthly and annual public transportation performance reports.

Citizens play an active role in the assessment of the quality of public transportation. They can make complaints regarding public transportation to the department of public transportation. The regulated identification of the vehicles and the staff allows

the citizens to submit their complaints on noticed irregularities within the public transportation system.

5.2 Treatment and Disposal of Solid Waste in the City of Belgrade

Case Study	Granting the concession for performing treatment and disposal of solid waste in the city of Belgrade
Objectives of PPP	Improve the services and rehabilitate the landfill while conforming to EU environmental regulations and standards
PPP Actors	City of Belgrade and concessionaire
Financial Structure	City invests land and infra EUR 40 million
Foreign Grants	Grant of French government for legal consultancy fees
Contract agreement	Concession (BOOT)
Contract duration	25 years
Risk allocation	Commercial risk assumed by private partner; market financial risks covered by tariffs-setting procedure; assets loss covered by an insurance policy
Management	City controls contract performance
Tariff setting	City pursuant to the contractual agreements
Strong Points	Concessionaire invests in communal infrastructure facilities and improvement of the services while bearing commercial risk
Weak Points	City will not collect significant revenue from the concession fee due to the concessionaire's investment being overvalued in comparison to the value of existing assets on the landfill

This case demonstrates the public competition process of granting the concession for treating and disposing of solid waste, aimed to ensure long-term financial, technical, and environmental sustainability of the solid waste services in the city without using public resources.

5.2.1 Background

The Vinča landfill has been operated for 25 years by the city public enterprise “Gradska čistoća” (PUC GC), which handles collection and disposal services in the territory of Belgrade. The amount of waste landfilled in 2002 was about 400,000 tons with an increase to 530,000 tons in 2005. The population covered by the waste collection

service of PUC GC was about 1.45 million, with a unit generation of about 320 kg per capita per year. Future waste generation is likely to continue to grow in line with economic growth, which is predicted to be high in Serbia over the coming years with EU accession approaching.

The city of Belgrade and the Republic of Serbia do not have budget resources for the rehabilitation of the Vinča landfill so that it may be brought up to current environmental and waste management regulations and standards. Therefore, in the course of 2006, the government of Serbia passed the proposal for the city of Belgrade to grant the concession for the construction, maintenance, and use of the facilities for the receipt, treatment, and disposal of solid waste on the Vinča landfill with the purpose of performing municipal services within those facilities.

The International Finance Corporation (IFC), a member of the World Bank Group, was selected to advise the city of Belgrade for the structuring and implementation of the PPP.

Because of the changes that occurred in the political establishment of the city of Belgrade, and the adjustments in the technical features to be applied to solid waste management, the city has decided not to engage a concessionaire. However, we have chosen to illustrate the key elements of the concession that should have been established.

5.2.2 The main principles of the PPP

- *Possibility for achieving benefits for both the city and the concessionaire.* The city of Belgrade should: (a) improve the quality of the services in the city, (b) rehabilitate the Vinča landfill and bring it into conformity with applicable environmental and waste management regulations and standards, and (c) enhance efficiency and lower costs through the introduction of commercial principles. The private partner should obtain the rights to perform municipal services by using the existing facilities on the landfill under a symbolic concession fee payment, and to earn stable revenue over the long term with minimal risk to its collection.
- *The concession will be granted on the basis of a public tender procedure* governed by the Serbian Concession Law and the Concession Enactment of the PPP project (approved by the government of the Republic of Serbia in December 2006). Tender documentation includes all necessary elements and instructions for the preparation of bids by participants in the bidding process, including:
 - Instruction on how to structure the bid and the bidding form;
 - A form announcing the bidder and his acceptance of the bidding conditions in the public announcement;

- The nature and scope of the construction works;
- Deadline for the completion of construction;
- Technical documentation;
- Instructions on quality control guarantees and performance;
- Stipulation of the type of financial guarantee that fulfils bidders' financial and other duties;
- Type and content of the documents, which shall be presented as a proof of meeting all conditions for the participation in the public tender;
- Other elements relevant to the subject of concession.

Interested candidates were required to be qualified and to submit technical and financial offers, which would be supplemented with a bank guarantee for the tender procedure.

The tender procedure had two phases: the first phase is the evaluation of technical offers, and the second phase evaluated financial offers by all candidates whose technical offers meet the minimum requirements.

The prospective bidder had to meet the following technical, financial, and relevant experience requirements:

- Must have been active in the waste management sector for a minimum of five years, at least two of those in successful direct operation of an EU or EPA Class II-compliant landfill of at least one 500 tons per day (TPD) or larger;
- Must demonstrate experience in the operation of the runoff collection and treatment systems, and relevant experience in both the design of new landfills and successful closure of abandoned solid waste dump sites;
- Must demonstrate minimum financial experience in the development of a project staging plan for an existing or planned landfill.

During the due diligence phase bidders were invited to submit comments regarding the draft concession contract. A final version of the draft concession contract had to be produced prior to the submission of bids.

The concessionaire shall invest at all stages of the concession. The total investment program is expected to be worth approximately EUR 40 million and shall include: (a) the remediation to the greatest extent feasible of the existing waste dump site, (b) the construction of additional landfill cells around the original site in accordance with relevant regulations and standards, and (c) the closure of the existing landfill site once it has reached capacity and its aftercare. The

concession contract is structured in two phases: the active phase would have an expected duration of 12 to 14 years and the aftercare phase, a fixed, 10-year duration. At the end of the concession, the ownership of all new constructed facilities shall be transferred from the private concessionaire to the city.

- *The city will pay the concessionaire an amount* based on the agreed “tipping fee” per ton of municipal waste delivered by PUC GC to the landfill for disposal. The concessionaire will charge the “tipping fee” directly to those commercial and industrial entities that will dispose waste directly at the landfill (without utilizing the collection services of PUC GC).
- *The concessionaire will pay a concession fee* for using goods and performing activities; this will be a symbolic amount because its investment is greater than the value of existing landfill assets.
- *Risk sharing is regulated during the concession.* The low demand risk exposure is allocated to the private concessionary. The city, when adjusting for the “tipping fee” by request of the concessionary, will manage market financial risk. *Damage (loss) risk* is covered by an insurance policy. Obtaining an insurance policy is the contractual obligation of the private concessionary.
- *Protection of the employees actually employed in the city* PUC is regulated by the tender documents, which included guidelines such as the amount of necessary employment and qualified manpower for the realization of the concession.
- *The concessionaire shall provide performance guarantees: for the construction period* (10 percent of planned investment value for the construction period with a maximum limit of EUR one million) and *for the operation and maintenance period* (five percent of planned investment value for the operation and maintenance period, with a maximum limit of EUR one million.) The concessionaire shall maintain in full force and effect, throughout the concession contract, the following *insurance coverage*: contractors,’ pollution, legal liability, all risks, third parties, professional responsibility, workers, and property.

The concessionaire shall maintain records and prepare reports during the concession duration and submit them to the city. These reports shall include records on: amount, type and origin (municipality) of the solid waste, and any complaints that may have been lodged by the users. The city as a grantor shall have free and open access to the landfill and all the facilities for purposes of inspections.

- *The right to terminate the concession* enables the city of Belgrade to guarantee good performance on a public service; this is regulated by the agreement.

5.3 Belgrade Waterworks and Sewage

Case Study	Strategy for the development of the PPP transaction for Belgrade waterworks and sewage
Objectives of PPP	Construction of sewer network, improvement of wastewater treatment, and restructuring of the utility services
PPP Actors	City of Belgrade, Water direction, PUC “Belgrade Waterworks and Sewage” (BVK) and Private partner
Financial Structure	City budget revenue, private partner equity, borrowed money on capital market
Foreign Grants	European union grant
Contract agreement	Concession and DBFO contract
Contract duration	25 years
Risk allocation	Commercial risk assumed by private partner; market financial risks covered by the tariffs-setting procedure
Management	City does supervision of the contract’s performance
Tariff setting	City of Belgrade Assembly
Strong Points	Construction of local infrastructure with long term financial, technical, and environmental sustainability of the system, carrying it over into end-user affordability.
Weak Points	The private partner might be exposed to high commercial risk because of the lack of accurate data on state/status and operations of the existing utility system.

This case highlights the example of a strategic approach to finding an adequate model of the PPP transaction for Belgrade waterworks and sewage, aimed at the construction of needed infrastructure facilities, and an increase in efficiency of the utility system through its restructuring process.

5.3.1 Background

The water and wastewater system for the majority of the city of Belgrade are currently operated by the city public enterprise, “Belgrade Waterworks and Sewage” (BVK). Its service area covers 1.4 million people out of the city’s 1.6 million total. 3,700 employees perform BVK operations .

BVK has a comprehensive potable water supply system with service provided to virtually all people within its service area. Wastewater services are more restricted, in that

a sewer network connection is only available to some 50 to 70 percent of the potable water customers. With the exception of localized septic tank treatment, there are no other operational treatment facilities.

Because of the lack of budget resources and BVK income to be invested in the construction of a badly needed sewer network, the city decided to create a strategy for entering into a partnership with a private partner who is interested in investing in this public system.

The strategy for development of the PPP transaction falls into two phases:

- Phase one involved complete legal, financial, economical, environmental, and technical due diligence in the analysis of the existing water and wastewater system and operations, to be presented in a strategy report detailing the recommendations for the structure of the PPP.
- Phase two will comprise the implementation of the PPP contract including: marketing of the transaction, identification of a potential partner to the PPP, the drafting of contractual documentation, the tendering and selection of the winning bidder, and the negotiation and contracting of the PPP contract. This phase will be monitored by EAR and IFC.

As the first phase was completed, the city of Belgrade received the feasibility study for the establishment of a PPP in the water and wastewater system. This study identified and suggested an eligible model of PPP transactions to be selected and implemented by the city in the next phase.

5.3.2 Funding and Management

Table 5.1
Assumptions of the Study

Total resources shall be obtained in the next 25 years		
Investment description	Amount (EUR)	Percent
Capital maintenance and improvement of water system in the course of 25 years	407,000,000	41
Construction of sewer network and improvement of wastewater treatment	525,000,000	53
Restructuring of the PUC "Belgrade Waterworks and Sewage"	55,000,000	6
Total investment costs	987,000,000	100

Resources of financing

- Capital subsidies from the city budget: EUR 15 million during first three years of PPP
- EU Grant, beginning in fourth year of PPP
- Private partner resources: equity EUR 16.5 million or senior debt of EUR 15.0 million during the period of investment
- Resources generated through operations for capital investments
- Capital transfer from the environmental fund, established for Sava and Danube rivers protection of EUR 6.4 million per year.
- Borrowing EUR 77 million from the financial markets

Financial modeling/assumptions

- Debt/Equity ratio 70:30 (average in the region)
- Equity return requirement in the region 20–22 percent by year 15 of the concession
- Available dividends will be distributed to the investor beginning in year three, in order to achieve a target payback period for initial investor funding of five to six years
- Maximum senior debt tenor 22 years, under margin of four percent and upfront fee of 1.5 percent.

Communal services tariffs

Current water tolls (28.15 RSD/m³—households, 56.87 RSD/m³—legal entities) would, though gradually increase until 2019, reach a level of 132 RSD/m³. Therefore, water tariffs would not go above EUR 1.0 the timeframe of the PPP arrangements.

Customer survey

- A very high level of support for improvements in the treatment of wastewater to solve the problem of pollution in the Danube and Sava rivers
- A high desire among citizens for the city to prioritize activities that would lead to environmental improvements
- Low customer satisfaction with the quality of water and the condition of the water and wastewater system
- Strong support for partnering with the private sector to affect positive changes
- Overall willingness to pay for improvements to the system
- A preference for EU accession

Suggested eligible model for PPP transactions

1. Full integrated water, sewage, and wastewater concession
2. Separate partial concession for water and sewage services and DBFO for wastewater treatment plant
3. Partial concession for water and sewage services and separate contract with a private partner for the design, financing, operation, and maintenance of wastewater treatment assets

The main principles of full, integrated water, sewage, and wastewater concession are:

- ***Granting the concession*** for water, sewage, and wastewater would be based on the government of Serbia's decision to grant the concession, pursuant to the Serbian Concession Law. The agreement would be finalized between the city of Belgrade and the newly established enterprise "New BVK" (Special Purpose Company). New BVK as a SPC would be responsible for the fulfillment of the agreement. The PUC BVK and the selected private partner would establish this New BVK.
- ***The main criteria for the selection*** among the qualified private partners who meet investment requirements from tender documentation are the **proposed service charges**.
- ***The concessionaire would be responsible for:*** (1) operating and maintaining the existing infrastructures, (2) restructuring the PUC BVK, and (3) financing and executing capital investment in water, sewage, and wastewater treatment. The tender and the concession dictate the overall design, finance, construction, and operation of the new infrastructures.
- ***Financing for capital investment*** would come from internally generated funds (tolls), private partner's equity, and debt capital funding or public grants, if legally compatible with the legal statutes of the concessionaire.
- ***The concessionaire would take the risk*** of finance, construction, operation, and tariffs collection and improvement.
- ***The concessionaire may be the owner of the new infrastructures constructed,*** which have to be transferred to the city at the end of the concession. It would have the right to operate the existing infrastructures.

5.4 Parking Services in the Municipality of Kikinda

Case Study	Awarding a contract for parking services operation
Objectives of PPP	Development of parking services
PPP Actors	Municipality of Kikinda and “Parking System and Garage Ltd., Co.”
Financial Structure	Municipality invests land; private partner invests EUR 1,000,000
Foreign Grants	No
Contract agreement	Lease or *[Affermage] Contract
Contract duration	22 years
Risk allocation	Commercial risk assumed by private partner
Management	Municipality supervises contract performance
Tariff setting	Municipal Assembly per the request of private partner
Strong Points	Develop parking services and invest in parking assets without spending municipal revenues
Weak Points	Collection of land-use fees for the municipal budget is the source of income earned by the private partner through parking operation. Therefore, budget revenue is subject to the commercial risk that has to be passed on to the private partner.

This case illustrates how a PPP can be used by the public sector to attract innovative technology and knowledge from the market to develop modern parking services that were not developed by the municipality.

5.4.1 Background

The municipality of Kikinda entered into a partnership with the private company “Parking System and Garage” Belgrade. For the purpose of this analysis we received the description of the PPP transaction from the private company.

The granting of the utility services operation contract was done in accordance with the Law on Utility Services, the Law on Public Procurement, and the municipal assembly’s decision on granting a contract for the operation of public parking services in the town.

5.4.2 The Main Principles of Established PPP

- **Possibility for achieving the benefits for both the municipality and the company.** The municipality should achieve, without the investment of public resources: (a) developed parking services through the introduction of commercial principles in this underdeveloped utility service (b) introduce a highly functional system of paying for and carrying out the control of parking activities, and (c) improve revenue for the municipal budget. The company should acquire the right to realize stable revenue on a long-term basis as a means of recovery for investment made in parking services and the accepted commercial risks.
- *The operation and maintenance contract was granted on the basis of a public tender procedure.* A criterion for the selection of the best bid was the most economically advantageous bid, which was selected on the basis of the following subcriteria: technical solution for parking service, total value of investment, and parking tariffs.
- *The private partner shall invest EUR one million in* parking places (open carparks and garage carparks) and the operation equipment (for collection of parking tickets and its control), and will maintain parking facilities and equipment.
- *Collected revenues from the parking services are shared* between the municipality and the company. **Ten percent** of realized revenue goes to the municipality, and the rest, **90 percent**, goes to the company for the term of 22 years. An agreed upon portion of the revenue is paid to the municipality as a fee for using the land for parking locations.
- *Risks are shared during the contract.* *Demand risk* is taken over by the private partner who collects revenues from the users of the parking services. *The municipality will consider market risk* during parking ticket level adjustments. The ticket level should be corrected in accordance with the average ticket price of three big cities in the region. The ticket level is decided and adopted by the municipal assembly. *Damage (loss) risk* is the responsibility of the private partner who can use an insurance policy.
- *Contractual obligations of the private partner are:* (a) to develop parking services through investments of EUR one million, (b) to perform parking services by introducing commercial principles, and (c) to introduce a highly functional system of paying and carrying out the management of parking activities.
- **The private partner had to submit a large bond** in order to assess the tender. During the signing of the contract the private partner was requested to submit a payment guarantee of all financial liabilities toward the municipality until the end of the contract.

- *The private partner shall maintain records* and prepare reports during the contract duration and submit them to the city once a year.
- *The municipal traffic department is responsible* for overseeing the operations of the parking service. The key objective of the contract supervision is the monitoring of the collected revenues from parking services, due to revenues being shared between the municipality and the company. This is enabled by a modern software package for the online management and operation of the parking service, created by the company. The parking fee payment function by text messages and the collection control by PDA devices are only a part of the integral information system, which monitors the company's operations.
- *The municipality has a full right to cancel the contract* if the private partner fails to fulfill its contractual obligations. This right enables the municipality to guarantee the performance of parking services to the citizens. In case of the contract termination, the municipality has the preemptive right to purchase the installed equipment and garage carparks. If the private partner terminates the contract, it is obliged to cover all costs that have been incurred by the municipality by this contract cancellation.

5.5 Maintenance of Sanitation and Landfills in the Smederevska Palanka Municipality

Case Study	Granting a contract for maintenance of sanitation and landfills of the municipality of Smederevska Palanka
Objectives of PPP	Development of the utility services
PPP Actors	Municipality of Smederevska Palanka and Trojon & Fischer EKO
Financial Structure	Municipality invests land; private partner invests EUR 600,000
Foreign Grants	No
Contract agreement	Operation and maintenance contract
Contract duration	15 years
Risk allocation	Commercial risk assumed by private partner
Management	Municipality supervises contract performance
Tariff setting	Municipal Assembly
Strong Points	Private partner invests in improvement of public service and development of landfill while assuming tariff collection risk
Weak Points	Municipality does not collect any revenues from service operations

The case illustrates a long-term development plan for solid waste disposal through the granting of a contract for maintenance of sanitation and landfills to a private partner. The municipality has become the supervisor of the public service operation.

5.5.1 Background

The contract between the Municipality of Smederevska Palanka and the Serbian-German Utility Company Trojon & Fischer EKO (T&F Company) was signed in August 2006. Granting of the operation and maintenance contract of the utility service was done on the basis of the Law on Utility Services and a municipal assembly decision granting an operating and management contract of/for maintenance of sanitation and landfills.

The municipality is obligated to ensure adherence to the decision on municipal services and render assistance to T&F in their start-up phase.

In the beginning of 2006, T&F Co., and the GTZ Project, “Modernization of Municipal Services” started a joint PPP project aimed at improving solid waste management. The project encompasses a public awareness campaign on the ecological and economical aspects of waste management directed at citizens in all parts of Serbia, as well as in the municipality. Intensive education and information activities were done for the illumination of citizens of Smederevska Palanka through a media campaign, school activities, seminars, publishing of informative material, etc., all in cooperation with the municipal administration.

5.5.2 The main principles of the established PPP

- *Possibility for achieving the benefits for both the municipality and the T&F Company.* The municipality should, without investment of the budget funds: (a) develop and improve utility services, (b) maintain landfills and eliminate illegal waste dumps, and (c) improve organization and efficiency through the introduction of commercial principles in utility service operations. The operation and maintenance contract gives the T&F Co. responsibility for: the operation and maintenance of a utility’s assets and the financing of development of utility services. In return for assuming this responsibility, the company is given rights to collect revenues for the contracted period of 15 years. The duration can be extended to 25 years.
- *The operation and maintenance contract was granted on the basis of a public tender procedure.* Interested candidates were required to demonstrate their qualifications to perform maintenance of sanitation and landfills and to submit technical and financial offers, which were supplemented with bank guarantees

for the tender procedure. The main criteria used to evaluate qualified candidates' financial offers were the tariffs proposed for waste collection, disposal services, and sanitation.

The private partner shall invest EUR 600,000 in the equipment necessary for utility services operation in their start-up phase, and in further services development during the 15-year contractual phase. Extending the O&M contract for an added 10 years depends on the total amount invested in the utility services development by the company during the first contracted period of 15 years.

- *Total revenues collected for services go to the company* to cover its initial investment, maintenance, and operation costs as well as projected profit for the entire period of the contract duration.
- **Demand risk is taken over by the private partner** who collects revenues from households and legal entities. Demand risk is estimated as significant, due to the fact that there are many households in rural settlements that have never used this public service. Fee collection from these beneficiaries will affect the revenue fulfillment by the private partner, particularly at the beginning of the operation. *Market financial risk* is not clear regulated by the contract. The Municipal Assembly may consider it during settlement of tariffs in the future. *Damage (loss) risk* is the responsibility of the private partner who can use an insurance policy.
- *T&F Co., took more than 72 employees* from the municipal public utility company "Mikulja," which previously carried out public sanitation services in the municipality.
- *Contractual obligations of the private partner are:* to invest in the development and improvement of utility services, to maintain landfills and eliminate illegal waste dumps, and to improve organization and efficiency through the introduction of commercial principles in the utility service operation.
- **Providing guarantees by the company.** The security of contract obligations is not regulated by the operation and maintenance contract. The operation and maintenance contract regulates the responsibility of the company to insure permanent functionability of the utility's assets, equipment, and installations.
- *The company shall maintain records and prepare reports* during the contract duration and submit them to the municipality on a yearly basis. All members of the Municipal Assembly have a right to be informed or receive reports regarding the company's operation by request.
- *The municipality has a full right to cancel the operation and maintenance contract* if the private partner fails to fulfill its contractual obligations. The

company also has a right to cancel the contract, with a notification period of a minimum of six months. This notification period is needed for the municipality to regulate further performance by the utility services in case of the cancellation of the the contract.

- **Guaranteed performance standards for users.** Thanks to modern mechanization and qualified human resources, T&F strives to fulfill the needs of citizens and local government with the aim of environmental protection, healthier living, and more beautiful surroundings.

Public-Private Partnerships takes a look at the success and failures of such agreements between government and the private sector in Central Europe. This book covers the development policies and projects in Bulgaria, Croatia, Hungary, Poland, and Serbia that have attempted to alleviate the burden on governments to fund the largest development projects as they have formed formal partnerships with the private sector. These partnerships are typically designed to provide better public services or better infrastructure, while alleviating risk, even if they may encounter serious regulatory barriers if the legislative framework is not properly in place. Leading experts from around the region have contributed to its findings, and also focused on such important elements as EU funding that has driven many such projects across the region.

After a brief introduction by Gábor Péteri, country reports follow on:

- The Marketization of Public Services at the Municipal Level:
Public-private Partnerships in Bulgaria
Stefan Vladkov and Angel Markov
- Public-private Partnerships in Croatia: Institutional Framework and Case Studies
Dubravka Jurlina Alibegovic
- Risk Assessment of Public-private Partnerships Implemented in Hungary: Risks, Management Efficiency, and Fiscal Relations
Charles Jókay
- Public-private Partnerships in Poland: Overcoming Psychological Barriers and Rigid Regulation
Rafal Stanek and David Toft
- Public-private Partnerships in Serbia: Towards Policies That Provide Risk Sharing and Value-for-Money Investment
Tatijana Pavlovic-Krizanic and Ljiljana Brdarevic



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